Higher Business Management

Management of People and Finance
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Management of People and Finance

Unit Content

Outcome 1

1 Apply knowledge and understanding of how the management of people can meet the objectives of large organisations by:

1.1 Describing approaches that could be used to manage human resources effectively

1.2 Describing approaches that could be used to motivate staff to improve effectiveness

1.3 Explaining how employee relations can impact on the success of a large organisation

1.4 Describing the impact of current employment legislation

Outcome 2

2 Analyse how the management of finance contributes to the effectiveness of large organisations by:

2.1 Describing sources of finance suitable for large organisations and giving reasons for their use

2.2 Detailing the purpose of final accounting statements

2.3 Describing accounting ratios and outlining the use or limitation of ratio analysis

Command Words

<table>
<thead>
<tr>
<th>Command Word</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compare</td>
<td>Identify the similarities and differences between two or more factors</td>
</tr>
<tr>
<td>Describe</td>
<td>Provide a thorough description - look at the marks allocated to work out how many points you must give</td>
</tr>
<tr>
<td>Discuss</td>
<td>Offer reasons for and against</td>
</tr>
<tr>
<td>Distinguish</td>
<td>Identify the differences</td>
</tr>
<tr>
<td>Explain</td>
<td>Give a detailed response: show costs and benefits</td>
</tr>
<tr>
<td>Identify</td>
<td>State or Name (usually Q1 section1 only)</td>
</tr>
<tr>
<td>Justify</td>
<td>Give reasons to support (advantage)</td>
</tr>
<tr>
<td>Outline</td>
<td>State the main features</td>
</tr>
</tbody>
</table>
Management of People

Role and importance of human resources

Human Resources (HR) is concerned with the issues of managing people in the organisation.

The Human Resources department is responsible for many people related issues in an organisation.

Under the HR department’s remit are the following roles:

- The process of recruiting suitable candidates for the organisation
- Identifying and meeting the training needs of existing staff
- Ensuring employee welfare and employee relations are positive
- Ensure the working environment is safe for employees
- Raising awareness of current workplace legislation

The Human Resources Department also covers five key roles (FACES).

- **Executive role** – in this role the HR department are viewed as the specialists in the areas that encompass Human Resources or people management.
- **Audit role** – in this capacity the HR department will check other departments and the organisation as a whole to ensure all HR policies such as Health & Safety, Training, Staff Appraisal etc are being carried out in accordance with the company’s HR policy.
- **Facilitator role** – in this role, the HR department help or facilitate other departments to achieve the goals or standards as laid out in the HR policies of the organisation. This will involve training being delivered for issues that arise in the areas relating to people management.
- **Consultancy role** – the HR department will advise managers on how to tackle specific managing people issues professionally.
- **Service role** – in this capacity the HR department is an information provider to raise awareness and inform departments and functional areas on changes in policy.

Changing patterns of employment

Over the last 25 years the make-up of the UK’s working population has changed beyond all recognition. Some of the changes are as follows:

**Women at work**

- With employment law and equal pay legislation coming into place over the last 25 years, women are being encouraged to work and not be penalised for raising children.
- Employers offering flexible working practices or child care facilities at the workplace have also helped to make it easier for women with children to continue working.
Rise of part-time workers

- A huge increase in part-time staff has occurred again mainly due to more women being in the workplace and many only work part-time due to child care commitments.
- The increase in students going to college and university has also resulted in a large temporary workforce available for employers such as supermarkets, fast food restaurants and call centres to make use of.

Flexible working practices

- Again linked to the number of women in the economy now, job-sharing, teleworking and homeworking are more common than ever before.
- This means workers do not have to spend as much time in the workplace as the traditional 9 to 5 job, but workers can work from home or on the move due to advances in mobile office technologies with laptops and smart phones.

Tertiary/Service sector

- The process of deindustrialisation has resulted in Scotland turning away from shipbuilding and manufacturing to service sector jobs such as retail, tourism and banking. With these new openings thousands of jobs have been created in the Tertiary sector.

Public sector

- Scotland has a large number of public sector workers, people employed to work for the State in areas such as the councils, the police, education and the NHS.

Recruitment and selection

Firms recruit, select and train staff in different ways with varying degrees of success.

Without the right staff with the right skills, a business cannot make enough products to satisfy customer requirements. This is why organisations draw up workforce plans to identify their future staffing requirements.

Recruitment is the process by which a business seeks to hire the right person for a vacancy.

Before advertising the job, a job analysis is conducted to see if the position has to be filled at all. A job analysis identifies the roles and duties undertaken in the position. Sometimes elements of the job may be shared by existing staff. If the job does need to be filled, then the next stage takes place.

The firm writes a job description and person specification for the post and then advertises the vacancy in an appropriate place.
• **Job descriptions** explain the work to be done and typically set out the job title, location of work and main tasks of the employee.

• **Person specifications** list individual qualities of the person required, eg qualifications, experience and skills. These elements are arranged into 2 categories: essential and desirable. From this a view of the ideal candidate will be formed.

Firms can recruit from inside or outside the organisation.

• **Internal recruitment** involves appointing existing staff. A known person is recruited.

• **External recruitment** involves hiring staff from outside the organisation. They will bring fresh ideas with them but they are unknown to the company - will they fit in?

There are advantages and disadvantages to appointing internally or externally. With internal candidates their abilities are known to the firm, they know the culture and would need less training, as well as being the cheap option.

Internal promotion also is good for overall staff morale, but if you promote from within you then need to fill another vacancy.

Also with internal candidates the pool of candidates is severely limited; however externals can bring in new ideas and experience. External recruitment is expensive as job adverts cost money!

**Selection Methods**

Managers must decide on the best method to assess and select applicants for a job.

**Application forms** are the initial recruitment tool as applicants have to complete and answer background details and general questions about the suitability for the job.

**CVs or Curriculum Vitae**s may also be used, though usually with a cover letter. CVs run normally no longer than 2 pages and are calling cards to show off a person’s best attributes or skills. CVs follow distinct sections such as Education, Qualifications and Work Experience.

**References** are normally your current line manager and another person who can vouch for an applicant’s character. Depending on the job, references may only be asked for their opinion or report when the job has been offered to the successful candidate.

**Interviews** are the most common selection process used in the UK. They can take the form of one-to-one interview or a panel interview with several interviewers asking the questions.

**Tests may take several forms.**

**IQ Tests** measure a candidate’s mental skills including their numeracy, literacy and problem solving skills.

**Psychometric Tests** are used to find out a candidate’s personality and involve a series of statements to which a candidate would strongly agree, agree, disagree or strongly disagree.
with the statement. Conclusions on the candidate’s personality can be drawn from his/her responses.

**Medical/Fitness** tests measure a candidate’s physical suitability for a job.

**Attainment Test** is a demonstration of a learned skill. A secretary may be tested on her ability to type 100 words per minute without error.

**Aptitude Test** measures a candidate’s natural abilities related specifically to a job.

After the selection methods have been used, the right candidate will be selected and then offered the position. The unsuccessful candidates will also be informed.

**Training and development**

**Induction** is the training given to new workers so that they understand their role and responsibilities and can do their job. It involves health and safety information, meeting work colleagues, and learning about the company’s policies and procedures.

Staff should learn new skills throughout the course of their career to stay productive. Training improves **technical, personal or management skills** and will increase staff efficiency. There are two main training methods:

- **On-the-job training** where experienced members of staff explain a job or a skill.
- **Off the job training** where outside experts are paid to explain a job or a skill.

**Retaining workers** is important to a firm because it costs time and money to hire and train a replacement. Well trained staff are better at their job, increasing productivity and efficiency. Being good at their job increases employee motivation. The firm’s reputation will improve if they take good care of their employees and invest in their development. If employees are better at their jobs, less mistakes or errors will be made, which could save the firm money over time.

However well-trained employees may leave and go elsewhere.

**Appraisal and training** helps motivate staff and so improves staff retention.

Staff Appraisal is a yearly performance review between an employee and his/her line manager. They reflect on the year just passed, and then identify training needs or areas for improvement. There may have been specific targets which were set and these are also discussed to see if they have been met. Targets which have been met may result in a bonus or another financial reward.
What is motivation?

**Motivation** is about the ways a business can encourage staff to give their best. Motivated staff care about the success of the business and work better. A **motivated workforce** results in:

- **Increased output** caused by extra effort from workers.
- **Improved quality** as staff take a greater pride in their work.
- **A higher level of staff retention**. Workers are keen to stay with the firm and also reluctant to take unnecessary days off work.

Managers can influence employee motivation in a variety of ways:

- **Monetary factors**: some staff work harder if offered higher pay.
- **Non-monetary factors**: other staff respond to incentives that have nothing to do with pay, eg **improved working conditions** or the chance to win **promotion**.

**Payment methods**

Managers can motivate staff by paying a **fair wage**. Payment methods include:

- **Time rate**: staff are paid for the number of hours worked.
- **Overtime**: staff are paid extra for working beyond normal hours.
- **Piece rate**: staff are paid for the number of items produced.
- **Commission**: staff are paid for the number of items they sell.
- **Performance related pay**: staff get a bonus for meeting a target set by their manager.
- **Profit sharing**: staff receive a part of any profits made by the business.
- **Salary**: staff are paid monthly no matter how many hours they work.
- **Fringe benefits**: are payments in kind, eg a company car or staff discounts.

**Non-pay methods of motivation**

Managers can motivate staff using factors other than pay through:

- **Job rotation**: staff are switched between different tasks to reduce monotony.
- **Job enlargement**: staff are given more tasks to do of similar difficulty.
- **Job enrichment**: staff are given more interesting and challenging tasks.
- **Empowerment**: staff are given the authority to make decisions about how they do their job.
- **Putting groups of workers in a team** who are responsible together for completing a certain task.
Employee Relations

Workers and managers do not always work in harmony. Conflict and trouble between these different groups with different aims occur in the workplace. This relationship is called Employee Relations.

Trade Unions are the name given to the organisations which support and represent employees. Trade Unions have certain aims:

- To advance the interest of their workers
- To achieve the best working conditions for its members
- Negotiate pay deals for its members
- Attend grievance and disciplinary hearings in support of their members
- Provide members with legal advice and financial advice

Trade Unions operate a system called collective bargaining which means that together many people speaking with one voice can achieve better results than a solitary employee who could be easily ignored.

Some well-known Trade Unions are the National Union of Journalists (NUJ), UNISON and the Transport and General Worker’s Union (TGWU).

Employers’ Associations are the owners and managers version of Trade Unions. These groups often represent employers during any negotiation with the Unions.

The Advisory, Conciliation and Arbitration Service (ACAS) was created with the aim of improving employee relations between employers and workers. It is involved in disputes or disagreements between the differing parties. ACAS often ends up as an arbitrator in such disputes which means they assess the dispute and come to an independent resolution which the employers and workers decide to agree with.

There are three processes used in employee relations to try and reach a resolution in a dispute.

Negotiation is when employees and employers discuss their problems and issues together and try to reach a solution or compromise that is mutually acceptable.

Consultation usually occurs when a major change is being implemented into the workplace. In this model, employers ask or consult employees about their views on the issue (for example changes to the length of the working day) but they would also involve other stakeholders in this process. The decision employers take might not include any suggestions by employees.

Arbitration is when a dispute cannot be resolved. When this happens, a third party is called in who will make a judgement or ruling on the matter. ACAS is a well-known arbiter.
Industrial Action

There are occasions when disputes cannot be resolved amicably. This leads to different courses of action open to employees. This is called Industrial Action.

Industrial Action by Employees

Work to rule is a method of industrial action used by workers to make a point to employers. Working to rule means employees do exactly what their job entails and nothing more. They do the bare minimum and no favours.

Go slow is exactly what is says. Workers take their time doing tasks and duties, which slows down production, affecting the firm’s ability to meet customer orders.

Overtime ban occurs when workers themselves decide not to work over and above their regular hours. This can result in lost production for the firm and perhaps lose lucrative customer contracts because orders cannot be met in time.

Sit-in is a dramatic gesture, usually when a factory or office is in danger of closing. Workers occupy the workplace and refuse to carry out their work.

Strike is the most extreme case of industrial action. This is when employees withdraw their labour altogether. The most famous strike in modern times was the unsuccessful coal miners strike of 1984.

Industrial action by employers

Overtime withdrawal is when the extra work and pay that overtime can bring, is refused.

Lock-out means that the employees are barred entry from their workplace.

Closure is when the employers shut down the factory or office, meaning workers can’t provide their labour even if they want to.

Legislation

Employers need to follow certain laws and procedures in order to protect their staff and customers.

Staff are protected against age, sex, race or disability discrimination.

To prevent exploitation, the government has passed a number of laws that safeguard staff:

- National Minimum Wage Act (1999) - Workers are guaranteed a minimum hourly wage rate of £5.93 per hour in 2010.
Businesses must be careful to treat all workers fairly. They must offer equal pay and promotion opportunities for women and ethnic minorities.

- **The EU Working Time Directive** sets a limit on the number of hours staff can work in a week.
- **Parents are entitled to paid leave** from work soon after their children are born. The firms must keep their post open for when they return from maternity or paternity leave.

**Health and safety**

Staff should be protected from harm.

**Health and safety procedures** are put in place to prevent staff from being harmed or becoming ill due to work.

**The Health and Safety at Work Act 1974** is the primary piece of legislation covering occupational health and safety in the United Kingdom.

Health and safety procedures need to be in place when using dangerous equipment at work.

Health and safety procedures are enforced by the government.

All businesses are required by law to:

- Display a **health and safety poster**.
- Carry out a **risk assessment** to identify workplace risks, and then put sensible measures in place to control them. Potential risks include **trip hazards** and **asbestos**. The extra paperwork increases the total costs of the business.

Businesses are also responsible for ensuring the health and safety of their **customers**.
Management of Finance

Role and Importance of Finance

Finance is important to an organisation as the firm has to know how viable it is and balance profit with costs.

The Role of the Finance Department can be summarised:

**Prepare and create financial accounts** – such as Trading, Profit and Loss Account and the Balance Sheet.

**Keep and maintain financial records** – sales figures and records of expenditure would be held by the Finance department and used by other departments also.

**Prepare and plan internal financial information** – this would mainly be performed in the case of a budget, which is a financial plan and can help managers take corrective action.

**Analyse current financial performance** – how the firm has done in trading or expenses would be analysed primarily using ratio analysis tools.

**Pay creditors** – Finance Department would ensure that bills are paid to people the firm owes money to.

**Pay employees wages and salaries** – running the payroll system is another important task for Finance to undertake. Employees have to be paid!

Ratio Analysis

It is sometimes hard to compare different organisations' performance, or even the same firm's performance over the years. One method used by businesses to compare their performance is Ratio Analysis.

Ratio Analysis covers three areas:

- Profitability
- Liquidity
- Efficiency

**Profitability Ratios**

Profitability ratios measure how much profit and organisation makes. We will look at the three main profitability ratios.
**Gross Profit Percentage Ratio** works out the amount of profit from the buying and selling of goods. Two ways of improving this is to raise the selling price of the product, or to negotiate deals with less expensive suppliers.

The formula is:

$$\frac{GROSS\ PROFIT}{NET\ SALES} \times 100$$

**Return on Capital Employed (ROCE)** is the ratio often used by venture capitalists or investors such as the Dragons in Dragons’ Den.

This ratio calculates how much money an investor will get back after a period of time.

It is crucial that investors weigh up the amount they will receive from the investment with the risk involved and if they would have received as good a deal (or better) if they had left the money in a bank account accumulating interest.

The formula is:

$$\frac{NET\ SALES}{CAPITAL\ at\ START} \times 100$$

**Liquidity Ratios**

Liquidity ratios calculate the organisation’s ability to turn assets into cash in order to pay debts.

**Current ratio** or the **working capital ratio** demonstrates the firms ability to meet its short-term creditors. An ideal ratio of 2:1 is generally agreed. If the ratio is higher, 4:1 it could mean that the firm is inefficient and has too much money tied up in stock. On the other hand, a lower ratio value of 1:1 would mean that it may not be able to meet its debts quickly.

The formula is:

$$\frac{CURRENT\ ASSETS}{CURRENT\ LIABILITIES}$$

**Acid Test Ratio** is a more severe test of a firm’s capabilities to meet its debts. The formula is the same as the Current Ratio but with the added problem of writing off all stock. This is because it assumes that stock may be perishable, it may go out of date, or it may go out of fashion or become obsolete. In other words, the firm may be left with stock it cannot sell. An ideal value of 1:1 is generally accepted.

$$\frac{CURRENT\ ASSETS - STOCK}{CURRENT\ LIABILITIES}$$
Efficiency Ratio

Rate of stock turnover is an efficiency ratio which determines how quickly a firm goes through its stock.

A high stock turnover is preferable as this means stock is selling – marketing and purchasing are doing their jobs properly!

If stock turnover is low then this means stock is not being bought and there may be many reasons such as poor quality of goods, poor customer service or poor advertising.

The formula is:

\[
\frac{\text{COST OF GOODS SOLD}}{\text{AVERAGE STOCK} \times (\text{Opening Stock} + \frac{\text{Closing Stock}}{2})}
\]

Advantages and Disadvantages of Ratio Analysis

Advantages:

- Ratios help compare current performance with previous records.
- Ratios help compare a firm’s performance with similar competitors.
- Ratios help monitor and identify issues that can be highlighted and resolved.

Disadvantages:

- Ratio analysis information is historic – it is not current.
- Ratio analysis does not take into account external factors such as a worldwide recession.
- Ratio analysis does not measure the human element of a firm.

Users of financial information

- As you know different stakeholders in an organisation have an interest in a company doing well. Therefore many stakeholders pay great attention to financial information a firm may provide or publish.
- Owners would use the return on capital employed ratio to work out how much money they will receive back for their investment and decide whether to increase their stake in the firm or withdraw their capital.
- Managers will compare last year’s results with current performance using ratios. They will also compare what sales figures and budget projections are in line with actual figures. They will then make decisions based on this information which will affect the operations of the firm.
- Employees/Trade Unions would use financial information to look at the overall health of the organisation and decide whether their jobs are safe or if it is a good time to negotiate a pay rise.
- **Creditors** will normally be suppliers who will be interested to see if the firm is meeting its demands and in a position to pay its suppliers. Future contracts could depend on such issues.
- **Banks** are interested in the financial information published by the firm as they will gain insight into how capable the firm is of paying back any loans or mortgages they may have currently with the lender.
- Government/Inland Revenue are concerned with a firm’s financial information as it is the job of the Inland Revenue to tax company’s profits.
- They will aim to ensure the firm is being taxed properly.

**Cash Flow**

Companies need to budget and be aware of cash flow in order to stay solvent.

**Cash flow** is the movement of money in and out of the business.

- Cash flows **into** the business as receipts, eg from cash received from selling products or from loans.
- Cash flows **out** of the business as payments, eg to pay wages, supplies and interest on loans.
- **Net cash flow** is the difference between money in and money out.

**Profit** and **cash flow** are two very different things. Cash flow is simply about money coming and going from the business.

The challenge for managers is to make sure there is always enough cash to pay expenses when they are due, as running out of cash threatens the survival of the business.

**Insolvency**

If a business runs out of cash and cannot pay its suppliers or workers it is **insolvent**. The owners must raise extra finance or cease trading. This is why planning ahead and drawing up a **cash flow forecast** is so important, as it identifies when the firm might need an **overdraft**.
Calculating the cash flow

This is an example of a cash flow forecast for the next three months:

A sample cash flow table for January to March

<table>
<thead>
<tr>
<th>Item</th>
<th>Jan</th>
<th>Feb</th>
<th>Mar</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening bank balance</td>
<td>£2,000</td>
<td>£1,000</td>
<td>£1,250</td>
</tr>
<tr>
<td>Total receipts (money in)</td>
<td>£500</td>
<td>£750</td>
<td>£5,000</td>
</tr>
<tr>
<td>Total spending (money out)</td>
<td>£1,500</td>
<td>£3,000</td>
<td>£2,000</td>
</tr>
<tr>
<td>Closing bank balance</td>
<td>£1,000</td>
<td>-</td>
<td>£1,250</td>
</tr>
</tbody>
</table>

At the beginning of January, the business has £2,000 worth of cash. You can see that the total flow of cash into the business (receipts) for January is expected to be £500, and that the total outflow from the business (expenditure) is £1,500. There is a net outflow of £1,000 which means the projected bank balance at the beginning of February is only £1,000.

In February, there are expected payments of £3,000 and only £750 of expected income. This means that the business is short of £1,250 cash by the end of February and cannot pay its bills. An overdraft is needed to help the business survive until March when £5,000 worth of payments are expected.

A business can improve its cash flow by:

**Reducing cash outflows:**

- **Delaying the payment of bills** – getting to pay when you can afford it without dipping into savings or arranging loans is best
- **Securing better trade credit terms** – agreeing to pay suppliers over a longer period relieves the pressure on a firm with cash flow problems
- **Wage cuts** – letting non-essential employees go or reducing wages could be an option, though unpopular and puts a lot of strain on the remaining workers
- **Delay purchasing equipment** – putting off large capital outlays is common sense

**Increasing cash inflows:**

- **Chasing debtors** – getting the people who owe you money to pay or give them a shorter credit period would be advisable
- **Arranging a loan** – securing a bank loan can help the firm keep afloat during a difficult period
- **Divestment** – selling off assets is a quick way to raise cash
- **Arranging an overdraft** – this facility would help if the firm finds itself in a short-term cash flow crisis

All businesses need finance. There are a number of funding sources used by organisations.
Finance refers to sources of money for a business. Firms need finance to:

- **Start up** a business, eg pay for premises, new equipment and advertising.
- **Run** the business, eg having enough cash to pay staff wages and suppliers on time.
- **Expand** the business, eg having funds to pay for a new branch in a different city or country.

New businesses find it difficult to raise finance because they usually have just a few **customers** and many **competitors**. Lenders are put off by the risk that the start-up may fail. If that happens, the owners may be unable to repay borrowed money.

**Sources of Finance**

The most important source of finance for firms is **internal** in the form of retained profits. **External** sources may be short, medium or long-term.

**Short Term Sources of Finance**

**Bank Overdraft** – this is used to allow a term to continue trading over a BRIEF period when its needs for cash will exceed the money available. An overdraft limit is agreed by the bank, which means that the Organisation is able to withdraw limited amounts cash from the account when there is no money in the account. Interest is charged on the amount overdrawn and any cash paid into the account reduces the amount of the overdraft.

**Debt Factoring** – a firm selling its debts to a ‘factor’ for less than their face value. The factor collects the full amount from the debtor and his profit is the difference between the two. This enables small firms to avoid cash flow problems.

**Trade Credit** – negotiating a longer period between receiving goods and having to pay for them. This can provide a firm with more cash to use in the short term.

**Medium Term Sources of Finance**

**Bank Loans** – most common way for medium term finance, usually means for 2-4 years. Usually required for machinery or other equipment that will need to be replaced at the end of the period. Normally higher rate of interest is charged on loans than overdrafts. Loans are seen as more risky for a bank. Loan is paid back in agreed instalments.

**Hire Purchase** – often used to obtain equipment or vehicles. The cost plus interest is paid over an equal amount of instalments over a set period. The higher purchase company owns the items until the last instalment has been paid.

**Long Term Sources of Finance**

**Mortgages** – used to buy premises. Interest is added to loan at the beginning and the whole amount is usually repaid in equal monthly instalments over a period of years. The rate of interest charged will depend on the length of the mortgage and the collateral (security) offered. The longer the loan and the higher the collateral, the lower the interest rate. Mortgages are often used by firms that cannot issues shares or debentures eg Sole Trader.
Debentures – limited companies can borrow money by selling debentures, which are long term 'IOU's'. Debenture holders receive interest annually and the firm must repay the loan at the end of the specified period of time.

‘Sale and leaseback’ – selling equipment/machinery to a finance company and leasing it back.

Capital – sole trader or partnership adding more money to the company.

Venture Capital – this finance may be offered to firms whose projects may be too risky to secure a bank loan.