Topic Overview	
Topic	Strategies and Management E4: Resources Management – Sources of Financing
Level	S3
Duration	3 lessons (40 minutes per lesson)

Learning Objectives:

1. To identify the main forms of financing,
2. To understand the characteristics of different forms of financing, and
3. To understand the benefits and drawbacks of different forms of financing.

Overview of Contents:	
Lesson 1	Short-term Finance
Lesson 2	Long-term Finance (Debts)
Lesson 3	Capital Finance

Resources:

- Topic Overview and Teaching Plan
- PowerPoint Presentation

Suggested Activities:

- Class Discussion
- In-class exercise
- After-class exercise

Lesson 1	
Theme	Short-term Finance
Duration	40 minutes

Expected Learning Outcomes:

Upon completion of this lesson, students will be able to:

1. identify the main forms of short-term borrowing,
2. describe the characteristics of term loan, trade credit and government assistance, and
3. describe the benefits and drawbacks of short-term financing.

Teaching Sequence and Time Allocation:

Activities	Reference	Time Allocation
Part I: Introduction		
✧ Teacher starts the lesson by a discussion with students of how to obtain funds for business expansion.	PPT #2 – 3	8 minutes
✧ Teacher explains the concept and definition of short-term and long-term financing.	PPT #4 – 5	6 minutes
Part II: Content		
✧ Teacher introduces the major types of short-term financing and their characteristics.	PPT #6 – 7	5 minutes
✧ Teacher further explains the following types of short-term financing:		
■ Banking facilities – term loans and loans with line of credit (e.g. overdraft and credit card)	PPT #8 – 9	10 minutes
■ trade credit	PPT #10	
■ government assistance programme	PPT #11	
✧ Teacher explains the benefits and drawbacks of short-term financing.	PPT #12 – 13	6 minutes
✧ **Activity 1: After-class exercise** ■ Teacher explains the activity to students, asking them to perform a research on different kinds of loan facilities for discussion in the next lesson.	PPT #14	3 minutes
Part III: Conclusion		
✧ Teacher concludes the lesson by reviewing the key points covered.		2 minutes

Lesson 2	
Theme	Long-term Finance (Debts)
Duration	40 minutes

Expected Learning Outcomes:

Upon completion of this lesson, students will be able to:

1. name the main forms of long-term debts,
2. explain the characteristics of the main types of long-term loans, and
3. select appropriate types of long-term loans in cases.

Teaching Sequence and Time Allocation:

Activities	Reference	Time Allocation
Part I: Introduction		
✧ Teacher recaps the purpose and sources of short-term finance and introduces the concept of long-term loan.		2 minutes
Part II: Content		
✧ Teacher describes major types of long-term financing and their characteristics, including:	PPT #2 – 3	5 minutes
■ banking facilities – term loan and mortgage as well as the concepts of floating and fixed interest rate.	PPT # 4 – 6	6 minutes
■ leasing including operating and finance lease	PPT #7	4 minutes
■ the characteristics and functions of debenture	PPT #8	4 minutes
■ government assistance programme	PPT #9	3 minutes
✧ Teacher explains the benefits and drawbacks of long-term debt.	PPT #10 – 11	6 minutes
✧ **Activity 1: Class discussion**	PPT #12	5 minutes
■ Compare the research results of students.		
✧ Teacher discusses the findings from students and makes conclusion.		3 minutes
Part III: Conclusion		
✧ Teacher concludes the lesson by reviewing the key points covered.		2 minutes

Lesson 3	
Theme	Capital Finance
Duration	40 minutes

Expected Learning Outcomes:

Upon completion of this lesson, students will be able to:

1. explain the common sources of capital finance: introducing new partners and issuing shares,
2. explain the two major forms of share issuing: private offering and public issue (IPO), and
3. describe the difference between Main Board and GEM.

Teaching Sequence and Time Allocation:

Activities	Reference	Time Allocation
Part I: Introduction		
✧ Teacher recaps both short-term and long-term loan financing and introduces capital finance		2 minutes
Part II: Content		
✧ Teacher describes major types of capital finance. ✧ Teacher explains the advantages and disadvantages of introducing new partners to source fund. ✧ Teacher explains the characteristics of two share issuing methods: private offering and public issue.	PPT #2 PPT #3 – 5 PPT #6 – 12	2 minutes 8 minutes 18 minutes
✧ **Activity 1: Class discussion** ■ Students are required to consider the best solution for financing the expansion of online trading business. ✧ Teacher discusses the suggestions provided by students and makes conclusion. (Note: there is no absolute answer but the purpose is to stimulate students' thinking and understanding of capital finance.)	PPT #13	5 minutes 3 minutes
Part III: Conclusion		
✧ Teacher concludes the lesson by reviewing the key points covered.		2 minutes

Source of Financing

Lesson 1 – Short-term Finance

1

Introduction

- Your elder sister's online trading business is running so good.
- She is now considering to expand her business.
- In order to do so, she is going to order $100,000 goods for sale and invest $500,000 to enhance her computer server and develop her trading platform through a website.
- However, she is running short of cash.
- Can you suggest some ways to help her?

2

Students are free to suggest any ideas. Teacher encourages them not just simply say '*borrowing*' because it is too general.
Split the discussion into two parts: the financing of goods for sale and financing of computer server and development of website.

Sources of Funds

Suggestions:

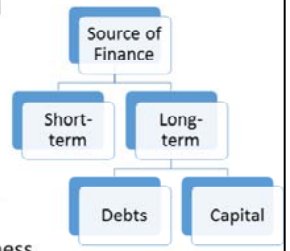
Purchase of goods	Hardware and website development
1.	1.
2.	2.
3.	3.
4.	4.
5.	5.

3

Teacher asks students to apply their suggestions to fit the purpose of purchasing of goods and development of website by completing the table.
Discuss with students whether their suggestions are appropriate or not. E.g. if students say using credit card to buy computer hardware, it may not be appropriate because short-term loan does not fit for purchase of non-current assets.
Teacher then discusses the concept of short-term finance and long-term finance.

Short-term Finance vs Long-term Finance

- Source of finance can be divided into short-term and long-term finance.
  - Short-term finance is basically by means of debt that due for repayment within a period of 12 months.
  - Long-term finance can be divided into:
    - Debt with a term to maturity greater than 12 months, and
    - Capital that owner invest additional funds in the business.



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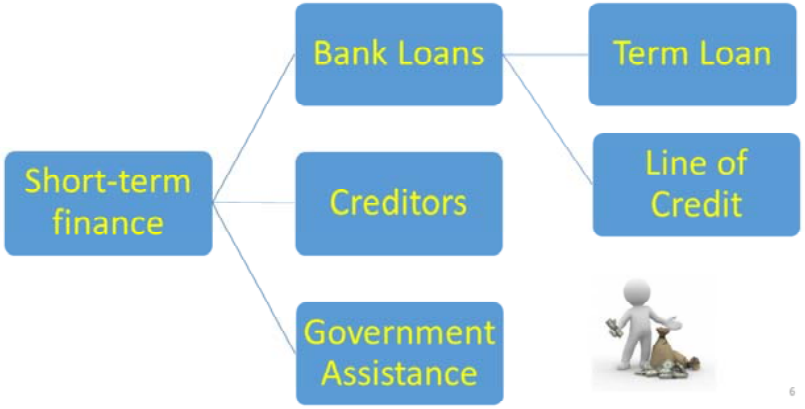
Teacher highlights the importance of the matching principle of source of finance.
For example, it is not appropriate to arrange a mortgage loan to pay to creditor because the interest expense is high.
Similarly, if a business uses short-term loan to purchase non-current assets, it is not easy to have the money back in near future to repay the loan.

Short-term Finance vs Long-term Finance

- It is necessary to match the source of finance to the use of fund.
  - e.g. use short-term loan to finance daily operation and long-term loan to purchase non-current asset.
- A mismatch may make the borrower falls into trouble.
  - e.g. , it is not appropriate to arrange a mortgage loan to pay to creditor because the interest expense is high.

5

Major Types of Short-term Finance



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Characteristics of Short-term Finance

- There is no credit check and therefore it is easy to obtain the loan.
- Generally the loan is unsecured (no collateral required) because the repayment is due at a short period of time which the default risk (risk of borrower fails to repay) is low.
- No restriction for the use of fund.
  - i.e. can use the fund for any purposes.
- Flexible repayment period e.g. from 1 day to 1 year.

7

Term Loan

- Bank loan can be divided into term loan and line of credit.
- Borrowers can receive cash quickly from the bank.
- Borrowers do not require good credit.
- It is good for new companies or companies without good borrowing record which they may not easy to get long-term loan.
- However, since there is no credit check, companies can only borrow a relatively small amount of fund for their operation.

8

Line of Credit

- An arrangement between a bank and a customer (company or person) that establishes a pre-set amount of unsecured credit balance that the bank will permit the borrower to maintain.
- The borrower can draw down on the line of credit at any time, as long as the borrower does not exceed the maximum set in the agreement.
- Example: overdraft facility, credit cards

9

Trade Credit

- When companies buy goods or services to other businesses 'on credit'.
- Usually the seller allows a grace period for the purchaser to settle the payment (e.g. a few weeks). E.g. a credit term of 30 days means the purchaser can repay the seller within 30 days after he received the goods without additional charge.
- Thus, trade credit is in fact a form of short-term debt in which the seller lends the purchase price to the purchaser at no charge.

10

Government Assistance

- Examples:
  - SME Funding Schemes provided by Trade and Industry Department.

  - Microfinance Schemes provided by Hong Kong Mortgage Corporation Limited.

  - These schemes are available for both short- and long-term finance.

11

Benefits of Short-term Finance

- Borrowers can obtain financing in a much shorter period of time as there is no credit check and assessment.
- Cash flow is secured and not affected because borrower can access to line of credit to pay for emergency situations.
- No restriction for the use of fund while many financing options have a narrow list of uses such as purchase of property.
- It is flexible because borrowers can choose the financing duration that is the best fit for their needs. i.e. repay earlier so to pay less interest.
- Trade credit is much better as it is at no cost of the borrower until the due date.

12

Disadvantages of Short-term Finance

- Borrower must pay interest and repay principal, otherwise he/she may be sued by the lenders in case of failure to do so.
- Amount borrowed is relatively small.
- Businesses that use credit cards for their short-term needs might see their profit margins suffer because of higher interest rates.
- If borrower is unable to pay to supplier by the due date, it will affect their relationship and stability of goods supplied.

13

After-class Exercise

- Perform a research and find different kinds of loan facilities available in the market which may help your elder sister as mentioned at the beginning of the lesson and compare your answers with your classmates' in the next lesson.

14

Teacher refers students to think about the question in slide 2 and ask them to search for appropriate sources that fit for the purposes as stated in the question.

The End

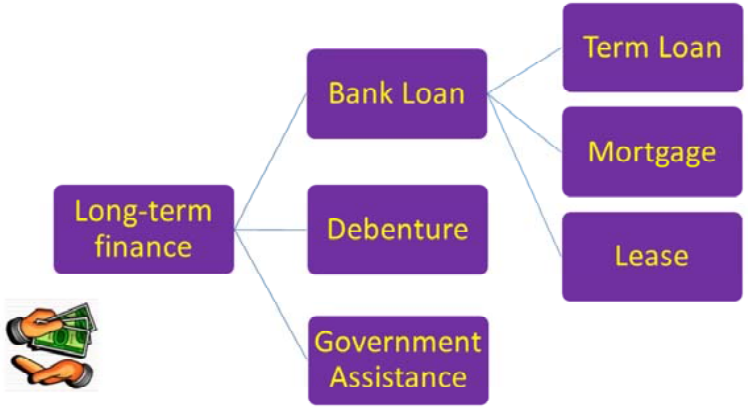
15

Source of Financing

Lesson 2 – Long-term Finance (Debts)

1

Long-term Finance (Debts)



2

Characteristics of Long-Term Debt

- Secured
  - The payment of interests and repayment of principal are secured on the property or undertakings of the company.
- Unsecured
  - No security is offered to the lender for payment of interest and repayment of principal.
- Marketable
  - Securities such as notes, bonds or debentures that are issued direct to investors and can then be traded in a secondary market.
- Non-Marketable
  - Loans arranged privately between two parties.
- Lenders have no voting right in the company to affect the business decisions and operations.

3

Long-term Loan

- Repaid in regular payments over a set period of time or at its maturity date.
- Interest rate can either be fixed or variable (float).
  - A fixed interest rate means that the percentage of interest will never increase, regardless of the financial market.
  - Floating interest rate will fluctuate from time to time with the financial market.

4

Long-term Loan

- The ability to repay over a long period of time is attractive for new or expanding companies, because:
  - they do no have sufficient funds for their operation at the beginning of their business.
  - they will increase their profit over time.
- Term loans are a good way of increasing capital in short time in order to raise a business' supply capabilities.
- For example, a company may use long-term loan to buy non-current assets for their operations.

5

Mortgage Loan

- Borrower pledges property such as building or equipment as security for a loan.
- If the borrower cannot repay the loan, the lender can take the property pledged from the borrower and sell it out to get their money back.
- In Hong Kong, there are two major basis for the charge of mortgage loan interest. They are:
  - bank prime rate (P); and
  - Hong Kong Inter-bank Offered Rate (HIBOR).
- Both of these two basis are under the floating rate system.

6

Teacher may tell students the current prime rate and HIBOR and explain how it operates in the mortgage loan arrangement.
E.g. Compare P-2% with HIBOR + 1% and see which one is good for the borrower and explain the risk of changes of P or HIBOR.

Lease

- A **lease** is a contractual arrangement under which the lessee (user) pay the lessor (owner) for use of an asset.
- It can be classified as:
  - Operating Lease: rental agreement that the lessee will not keep the asset after the lease term. For example: the hire of car for use of 2 weeks.
  - Finance (Capital) Lease: Lessee can keep the asset after the lease term. For example: hire-purchase.

7

Debenture

- A debenture is a document used by a company to evidence a loan, and the debenture holder, the person who provides the loan, is the creditor of the company.
- Payment of interest and repayment of the loan are not conditional on the company making a profit and the company has an obligation to pay on due date.

8

Government Assistance

- Examples:
  - SME Funding Schemes provided by Trade and Industry Department.

  - Microfinance Schemes provided by Hong Kong Mortgage Corporation Limited.

  - These schemes are available for both short- and long-term financing.

9

Students are required to search different kind of loan finance last lesson. Therefore, teacher can introduce another government resource: Youth e-start (www.e-start.gov.hk) during the activity session if students cannot find this source.

Benefits of Long-term Debt

- Stable – the cash flow is easy to forecast as the borrower knows how much to pay in the future for the interest and loan principal.
- Debt obligations are limited to the loan repayment period, after which the lender has no further claim on the business.
- The amount borrowed is relatively large so the borrower can get sufficient money for their use.
- Lenders cannot affect the business decisions and operations. The owners of the business can retain the ownership and control of the business.

10

Disadvantages of Long-term Debt

- Higher Interest rate and cost.
- Some long-term loan (e.g. mortgage) may impose restriction on the use of the money borrowed.
- Reduce future borrowing power.
- Payment of interest and repayment of principal are not conditional.
  - Most lenders provide severe penalties for late payments, which may include charging late fees, taking possession of collateral, or calling the loan due early.
- Investors may not prefer to invest in a company with high debt level because it is too risky (risk of bankruptcy).

11

Higher interest rate is incurred because long-term financing includes a greater span of time for default. A shorter term is less risky to the lender, as it is easier to forecast a borrower's financial status in the short-term than long-term.

Activity

- Compare different kinds of financing sources you have searched and discuss whether they are suitable for your elder sister or not!

12

Teacher discusses the findings from students and make conclusions. There are some suggestions for reference as listed below.

For purchase of goods, it is better to finance by short-term loan because the goods are held for sale and be able to converted into cash shortly. For example, overdraft or asking for a trade credit.

For purchase of computer server, it is better to finance by long-term loan because the server is held for use to earn incomes for several years. For example, mortgage loan, government assistance programme such as SME fund and Microfinance Schemes.

The End

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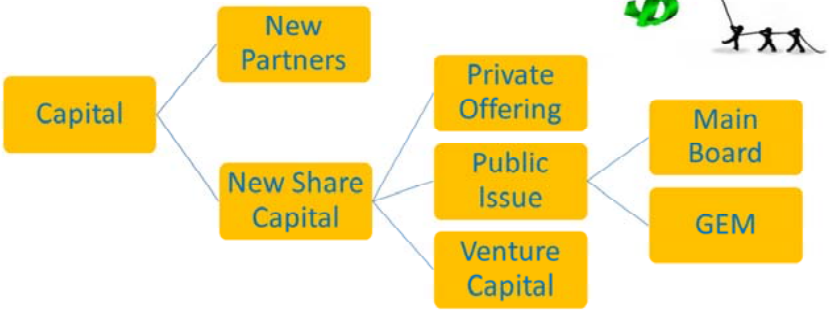
Source of Financing

Lesson 3 – Capital Finance

1

Capital Finance



2

New Partners

- Unlimited companies can introduce new partner(s) to invest in the business.
- Unlimited companies are companies which the owners with unlimited liability. i.e. the owners responsible for all debts of the business by their own.

3

Advantages of Introducing New Partners

- New partner can provide additional funds to the business.
- New partner can also provide additional skills that original owner may not proceed.
- Partners share the responsibilities and liabilities of the business.

4

Disadvantages of Introducing New Partners

- Original business owner has to give up absolute control of the business .
- Conflict with new partners
  - original business owner has to compromise with new partners especially when they disagree with each other regarding business decisions.

5

Share Capital

- Money raised by means of selling new shares to new investors (called shareholders).
- In return for the money paid, shareholders receive ownership interests in the company based on the proportion of their share capital.
- New shares can be issued privately or publicly.

6

Private Offering

- Additional shares issued to new investors selected by the previous owner(s).
- Shares cannot be traded in the stock market.

7

Initial Public Offering (IPO)

- An initial public offering (IPO) is a type of public offering where shares of a company are sold to the general public, on a stock exchange, for the first time.
- Through this process, a private company transforms into a public company (listed company).
- A company issuing shares is never required to repay the capital to its public investors.
- After the IPO, when shares trade freely in the open market, money passes between public investors.
- Can you tell any examples of listed company?

8

Teacher can give examples of recent IPO and ask students to give examples of listed company to ensure they understand what it is.

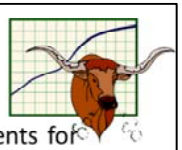
Reasons for Listing

- Raise additional funds to expand its business operations.
- Existing shareholders would like to realise part of their investment.
- Enhancing the image of the business.

9

Explain to students:
Pt 2: because shareholders can sell part of their holdings to outsiders/new investors.
Pt 3: listed company may give a positive image to the public as being large, profitable, powerful etc.

Main Board Listing



- According to the Hong Kong listing rules, the basic requirements for listing include the followings:
  - The company must have an adequate trading record under substantially the same management:
    - Not less than 3 financial years during which the profit attributable to shareholders must in the most recent year be at least $20 million and in two preceding years a total of at least $30 million.
  - Expected market capitalization of a new applicant at the time of listing must be at least $200 million, of which at least $50 million must be held by the public.

Source: Hong Kong Exchanges and Clearing Limited (HKEx)

10

Growth Enterprise Market (GEM)

- The Growth Enterprise Market does not require growth companies to have achieved a record of profitability as a condition of listing.

11

The removal of record of profitability enables growth enterprises to capitalize on the growth opportunities of the region by raising expansion capital under a well-established market and regulatory infrastructure.

Key Differences between Main Board and GEM

- The Main Board enables established companies that meet a higher profit or other financial standards to raise funds in the market.
- With effect from 1 July 2008, GEM has been positioned as a second board and a stepping stone towards the Main Board.

12

Activity 1 – Class Discussion

- If your elder sister wants to use capital finance for her online trading business expansion instead of loan, can you advise her which method(s) is/are appropriate and why?

13

Teacher discusses the suggestions provided by students and makes conclusion.
(Note: there is no absolute answers but the purpose of the discussion is to stimulate students to think and understand more about capital finance.)

The End

14

Section A: Multiple Choice Questions (@1, total 10 marks)

1. Which of the following is not a source of short-term financing?

A. Bond.
B. Overdraft.
C. Credit card.
D. Government assistance.

Level of difficulty: *

2. Companies selling goods or services to other businesses 'on credit' is called:

A. bad debt.
B. trade credit.
C. overdraft.
D. loan.

Level of difficulty: *

3. What is the benefit of using short-term bank loan?

A. There is no interest charge.
B. Borrowers do not require good credit.
C. Borrowers can borrow a large amount.
D. Borrowers can borrow at an amount at any time so long as the amount borrowed does not exceed the agreed limit.

Level of difficulty: **

4. An interest rate which fluctuates from time to time with the financial market is called:

A. bank prime rate.
B. fixed interest rate.
C. floating interest rate.
D. HIBOR.

Level of difficulty: *

5. A lease that allows lessee to keep the asset after the lease period is called:

A. finance lease.
B. operating lease.
C. mortgage lease.
D. instalment.

Level of difficulty: **

6. The payment of interest on debentures is _____.

A. unconditional.
B. at discretion of the borrower.
C. at discretion of the lender.
D. necessary when the borrower makes profit for the year.

Level of difficulty: *

7. Which of the following is not a benefit of borrowing long-term debt?

A. Stable.
B. Flexible.
C. Can borrow a larger amount.
D. Lenders cannot affect business decisions.

Level of difficulty: *

8. What is the benefit of introducing new partners?

A. New partners can control the business.
B. New partners can provide additional skills.
C. Partners has unlimited liabilities regarding the business obligation.
D. Shares can be traded in the stock market.

Level of difficulty: *

9. A company offers its shares to be sold on a stock exchange for the first time is called:

A. Private offering.
B. Initial public offering.
C. Introduction.
D. Right issue.

Level of difficulty: **

10. The expected market capitalisation of a new applicant at the time of listing must be at least $____ million.

A. 20.
B. 30.
C. 50.
D. 200.

Level of difficulty: *

Section B: Short Questions (20 marks)

*	1.	Briefly describe the characteristics of short-term financing.	(10 marks)
***	2.	As compared with the other sources, what are the benefits and drawbacks of using trade credit as short-term finance?	(6 marks)
**	3.	What is secured loan? Give one example of secured loan.	(4 marks)

Suggested Solutions

Section A: MCQs

1. A	2. B	3. B	4. C	5. A
6. A	7. B	8. B	9. B	10. D

Section B: Short Questions.

Question 1 (@2, total 10 marks)

There is no credit check and assessment and therefore the approval for the loan is quick and easy to obtain.
Generally unsecured because the loans are for short periods of time.
There is no collateral required against the loan amount.
No restriction for the use of fund i.e. it can be used for any purposes.
Flexible repayment period e.g. from 1 day to 1 year.

Question 2 (@3, total 6 marks)

Benefit:
There is no cost for the borrower until the due date.

Drawback:
If the borrower are unable to pay to the supplier, it will affect their relationship and stability of goods supplied.

Question 3 (4 marks)

A loan is secured when lender has claims against the borrower and against assets of the borrower when the payment of interest or repayment of principal is in default.
Mortgage loan is an example of secured loan.