**Q2. Gordons plc has an annual turnover of £3 million and a pre-tax profit of £400,000. It is not quoted on a stock exchange and the family owning all the shares has no intention of permitting the sale of shares to outsiders or providing more finance themselves. Like many small and medium-sized firms, Gordons has used retained earnings and a rolled-over overdraft facility to finance expansion. This is no longer seen as adequate, especially now that the bank manager is pushing the firm to move to a term loan as its main source of external finance. You, as the recently hired finance director, have been in contact with some financial institutions. The Matey hire purchase company is willing to supply the £1 million of additional equipment the firm needs. Gordons will have to pay for this over 25 months at a rate of £50,000 per month with no initial deposit. The Helpful Leasing Company is willing to buy the equipment and rent it to Gordons on a finance lease stretching over the four-year useful life of the equipment, with a nominal rent thereafter. The cost of this finance is virtually identical to that for the term loan, that is, 13 per cent annual percentage rate. Required. Write a report for the board of directors explaining the nature of the four forms of finance which may be used to purchase the new equipment: hire purchase, leasing, bank term loan and overdraft. Point out their relative advantages and disadvantages. (350 words max – you might want to simple create a table and explain pros and cons):**

|  |  |  |
| --- | --- | --- |
| Form Of Finance | Advantages | Disadvantages |
| Hire purchase | * Fixed rate loan. * Interest rate tends to be low. * Flexible (Can reduce monthly costs with the addition of a balloon payment). * Certainty * Easy and quick to arrange | * Monthly payment higher than on a lease due to the hire purchase not considering depreciation. * The finance institution owns the equipment until all payments are made. |
| Leasing | * Fixed rate finance * Certainty * Obsolescence risk * Available when other finance sources are not * Tax relief * Small intial outlay | * High rate of interest considering a leasing is more like a rental than a purchase. * Does not own the asset, the equipment, during or after the lease. |
| Bank Term Loan | * Bank can be very flexible with regard to the payments. * Grace period or repayment holiday. | * Not repayable at the bank on short notice. |
| Overdraft | * Flexible. * Easy to obtain at the bank for a company. | * Has to be paid in a few months or a year. * Can not withdraw the facility at short notice. * Interest is charged on excess drawings |

**Q3. Describe, explain and illustrate how a bank could find itself insolvent. (200 words max + tables if required)**

A bank would be described as insolvent if the institution can’t meet its financial obligations anymore. This can happen for many reasons. One of the first reasons is, if a the borrowers are not able to pay back the loans then the bank would face a shortage of money wnd would lose money which could lead to insolvency. A bank could also face insolvency if customers take out all their cash. It would lead the bank to be unable to loan money and therefore the bank would have more liabilities than assets.

Figures show how a bank can find itself insolvent due to customers not paying their loans:

