GCSE Business
Finance

Functions of the Accounts/Finance Department

- Keeps financial records/accounts/"the books"
- Draws up financial tables ➔ profit and loss account/balance sheet/cash flow/budgets
- Deals with wages
- Settles bills/pays creditors
- Collects/chases up debt
- Organises loans etc. ➔ liaises with banks.

Revenues and Costs

Turnover (Revenue)

Definition: The amount of money taken in by a business when selling a good or a service.

Calculation: Selling Price x Quantity Sold

Ways to improve turnover:
- **Increase price ➔** make more revenue per item sold
- **Reduce price ➔** may create demand/sell more goods to increase total revenue
- **Increase promotion/advertising ➔** may attract more customers/ sales.

Profit

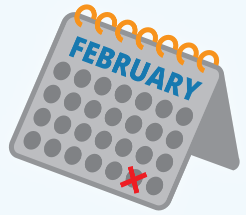
Definition: The difference between the total revenue of a business and the total costs of a business, when revenue is greater than cost.

Calculation: Total Revenue – Total Costs

Fixed Costs

Definition: Costs which do not change with the number of goods made or sold.

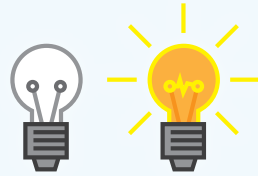
Examples:
- rent for the shop
- monthly lease on equipment and machinery
- payment of business rates on premises.



Variable Costs

Definition: A cost that changes with the number of goods produced/sold/output.

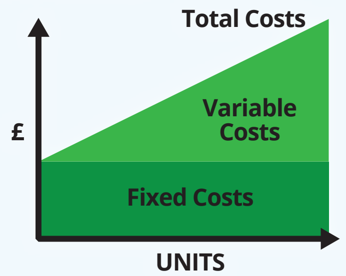
Examples:
- raw materials
- electricity and gas.



Total Costs

Definition: The full amount of money spent by a business when producing the goods sold in a particular period. It is calculated by adding its fixed costs to its variable costs.

Calculation: Fixed Costs + Variable Costs



Contribution

Definition: The amount taken from the cost of selling every good used towards paying the fixed costs of producing that good. Contribution per good is selling price minus the cost of the good.

Calculation: Selling Price – Variable Costs

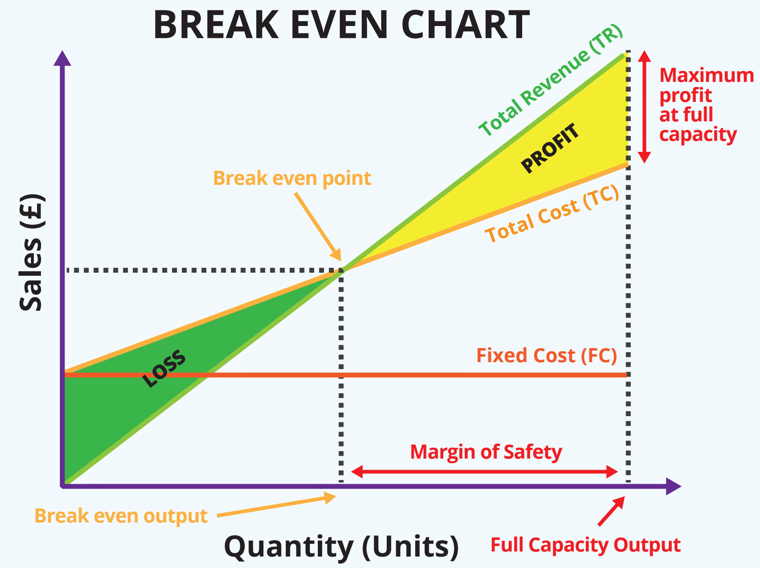
Break-Even

Definition: Occurs where the total amount of money taken in by a business is the same as the amount of money paid out. Neither a profit nor a loss is made where total revenue equals total cost.

Calculation: $\dfrac{\text{Fixed Costs}}{\text{Contribution per unit}}$

(Contribution = Selling Price – Variable Costs)

Graph:



Sources of Finance

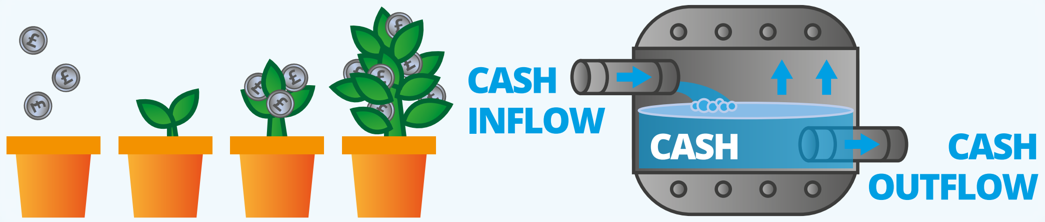
Factors a business will need to consider if it is trying to raise extra finance

- **Availability of finance ➔** some banks may not lend ➔ willingness of banks to lend
- **Interest charged ➔** will add to cost / may add to price
- **Time for repayment ➔** to spread cost over time / lower repayments
- **Amount of money needed ➔** banks not willing to lend large amounts / effect on interest
- **Effect on business ownership ➔** more shareholders = less control
- **Administration charges ➔** will add to costs ➔ reason for borrowing ➔ long-term / short-term ➔ capital / expenses etc.

Cash Flow

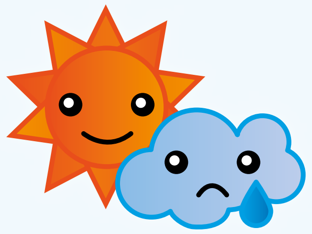
Cash Flow

Definition: The money that flows into and out of a business on a day-to-day basis.



Cash Flow Forecast

Definition: Sets out a business' expected inflows and outflows of cash over a period of time.



Why are cash flows important:

- **May be part of a business plan ➔** when a business wants to borrow money
- **Forewarns about future possible cash flow problems ➔** helps a business to put a plan in place
- **Helps bank decide whether to give loan ➔** suggests ability to repay.

External events which may result in the actual cash flow being different from the forecast:

- **Increased/decreased taxes ➔** will change the amount of cash held
- **Interest rates ➔** change in amount of cash given to banks
- **Legislation ➔** may change the services offered and therefore cash available ➔ minimum wage
- **Weather ➔** will change number of goods sold/ expenditure of customers
- **Increase in costs ➔** wages/fuel etc.
- **Inflation ➔** increase costs ➔ reduce customers
- **Competition ➔** attracts customers away
- **Breakage of equipment ➔** fewer items to sell ➔ costs of repair.

Turnover (Revenue)

Definition: The value of sales / income / revenue of a business / money made from selling goods or services.

Calculation: Selling Price × Quantity Sold

Expenses of a Business

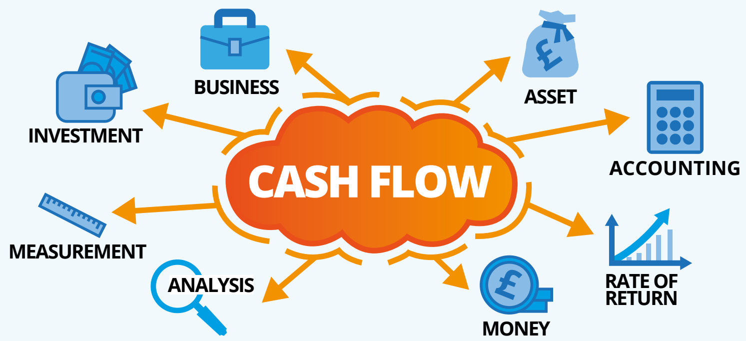
Examples:

- rent / salary / wages / utilities / tax / fuel / insurance / marketing / telephone / broadband / business rates.

Net Cash Flow

Definition: Another word for predicted 'profit' on a cash flow forecast.

Calculation:
Net Cash Flow = Total Inflow – Total Outflow



Opening Balance

Definition: The cash available to a business at the start of a month, carried over from the closing balance of the previous month.

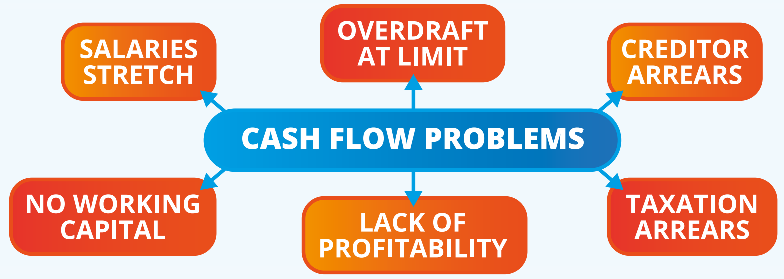
Closing Balance

Definition: Cash remaining in a business at the end of a month.

Calculation:
Closing Balance = Opening Balance + Net Cash Flow

Ways to Improve Cash Flow Position

- **Reducing staff**
  - ☑ will reduce the wages bill
  - ☒ but this may lead to an inferior service ➔ or reduced output ➔ loss of customer ➔ so revenue may fall.
- **Buying cheaper materials**
  - ☑ will reduce production costs ➔ and lead to lower prices ➔ which could generate more custom
  - ☒ but customers will not be happy about the quality of the product ➔ so sales may fall.
- **Delaying payment to creditors**
  - ☑ will allow cash to be used for other purposes
  - ☒ but suppliers may become reluctant to offer trade credit.
- **Chasing up bad debtors**
  - ☑ may generate cash
  - ☒ but may lead to cash problems for customers ➔ who may not be able to pay any debts.
- **Increasing promotions**
  - ☑ may lead to increased sales
  - ☒ but may have no impact on sales ➔ and will be expensive to set up.
- **Raising finance/from bank/selling assets**
  - ☑ can generate cash to pay day-to-day bills
  - ☒ but this will have consequences ➔ the money loaned will have to be paid back.
- **Increase/reduce price**
  - ☑ may lead to more revenue if sales don't fall
  - ☒ but revenue may fall if they get fewer customers.

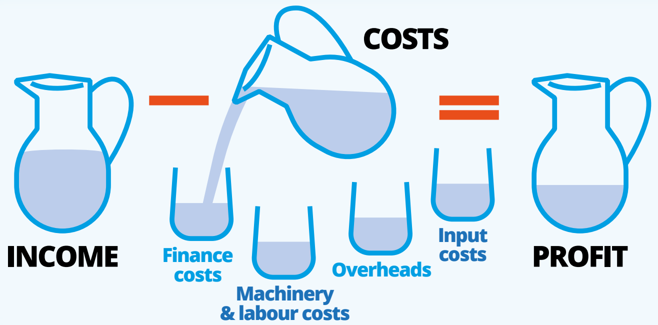


eduqas wjec cbac

Profit and Loss

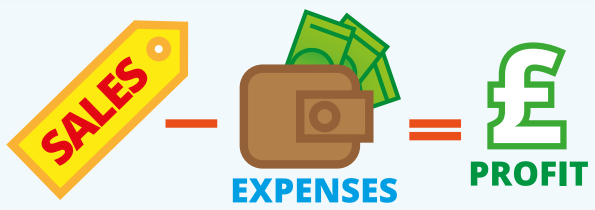
Profit

Definition: The difference between the total revenue of a business and the total costs of a business, when revenue is greater than cost. It is important in being precise in using this term: stating "money made" can be confusing.



Ways to Increase Profit

- Decrease price
  - ☑ increase market competitiveness
  - ☒ looks like poor quality ➔ no increase in sales means lower profits.
- Increase the price charged
  - ☑ will increase the revenue that is made per sale/ customer
  - ☒ but may lose customers if they don't want to pay the higher price.
- Reduce costs / example of cost reduction
  - ☑ this will ensure that the business makes more profit per customer
  - ☒ but the quality of the service may fall resulting in a loss of customers and less revenue.
- Increasing marketing
  - ☑ may attract more customers / increase sales revenue
  - ☒ but it will increase costs.



Profit and Loss Accounts

Definition: A financial statement showing a business' sales revenue and costs and thus its profit or loss over a period of time. Profit and loss accounts are also called income statements.

	Sales Revenue
(minus)	Cost of Goods Sold
(equals)	Gross Profit
(minus)	Expenses
(equals)	Net Profit

Gross Profit: The profit made before expenses have been paid.

Calculation: Total Revenue – Costs of Goods Sold

Gross Profit Margin: The gross profit expressed as a percentage of sales. It is calculated using the formula:

$$\text{Gross Profit Margin} = \frac{\text{Gross Profit}}{\text{Sales}} \times 100$$

Net Profit: The final profit made by a business after all costs have been paid.

Calculation: Gross Profit - Expenses

Net Profit Margin: The net profit expressed as a percentage of sales. It is calculated using the formula

$$\text{Net Profit Margin} = \frac{\text{Net Profit}}{\text{Sales}} \times 100$$

Reasons for changes in the Gross or Net Profit Margin:

- Sales Revenue has increased or decreased
- Costs of Goods Sold have increased or decreased
- Expenses have increased or decreased.

Financial Performance

Stakeholders Interested in Business Accounts

- **Directors** ➔ security of position ➔ to measure whether past planning has been a success ➔ and to aid decision-making for future
- **Worker** ➔ to see whether the business is successful ➔ which will impact on job security ➔ also could business afford wage increase
- **Managers** ➔ to see whether the business is successful ➔ which will impact on job security ➔ also could business afford salary increase ➔ do they qualify for bonus? ➔ has their management been effective?
- **Shareholder/investors** ➔ to see whether the business is successful ➔ which may effect value of shares ➔ influencing shareholder wealth ➔ and level of dividend ➔ which adds to shareholder income ➔ decisions on keeping, buying or selling
- **Customer** ➔ may want to know about survival of business ➔ which will decide whether it is worthwhile being a customer ➔ or should contracts be negotiated elsewhere? ➔ also might high profits suggest business charging high prices?
- **Supplier** ➔ also may want to know about survival of business ➔ to find out whether the business is likely to be able to pay its trade credit
- **Bank** ➔ may also want to know about survival of business ➔ to find out whether the business is likely to be able to pay its loans/ overdraft
- **Government** ➔ as customers ➔ to find how much tax will be collected from the business ➔ does it consider profit to be excessive? ➔ should more tax be levied?
- **Competitor** ➔ to make comparisons ➔ to aid planning/competitive strategies.