

Key Term	Definition	Example and / or Formula
start-up costs	the costs incurred when setting up a business	Sign, Market Research, Furniture, Equipment
operating (running) costs	– the costs incurred in the day-to-day running of a business. These can also be known as overheads	Stock, Materials
Fixed Costs	Costs which don't change with output (how many items you make or sell)	Rent, Rates, Insurance, Salary
variable costs	Costs which do change with output (how many items you make or sell)	Raw Materials, Stock, Wages, Electric used to make product
Direct Costs	Costs that are directly linked to making the product	Raw Materials and staff wages
indirect costs	Costs that aren't directly linked to making the product	Rent, Phone, Bills and Salaries
total costs	All of your costs added together	Fixed Costs + Variable Costs
Profit	revenue is more than expenditure	Revenue - Expenditure
loss	expenditure is more than revenue	If you have -£500 at the end of the year
Revenue	How much money is coming into the business	Total sold x Selling Price Selling goods, hiring out equipment/premises, selling shares
Expenditure	What businesses spend their money on	Rent, rates, stock, gas

Key Facts

Businesses generate revenue (make their money) by selling products or services. They can also generate revenue from renting out part of their premises or equipment too!

Businesses have to spend money (expenditure) in order to succeed. They need to reinvest in stock that is selling well and try to improve the business through expansion of products sold, services offered etc. They might need to spend money on promotion and marketing to encourage people to buy their products

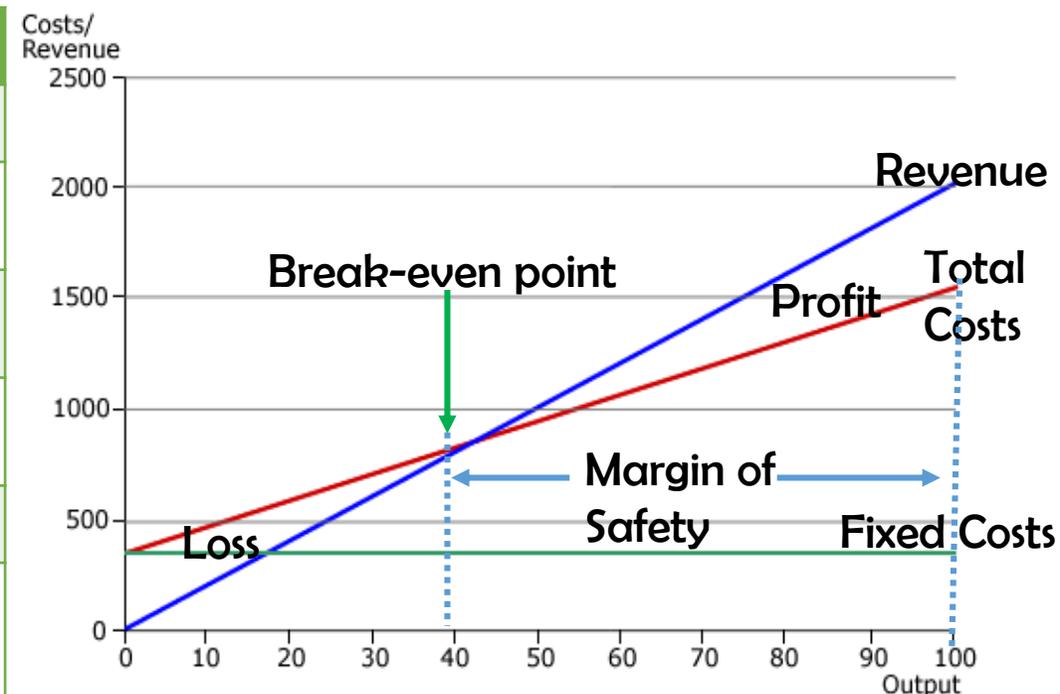
Expenditure is anything a business pays out and overheads are the everyday running costs of a business

Businesses must know how much money is coming in (revenue) and going out (expenditure), before they can work out whether the business has made a profit or made a loss

You must remember the formulas - as these are not given in the exam!!



Key Term	Definition	Example and / or Formula
Break Even	Works out how many items a business must sell in order to make a profit	
Margin of Safety	The difference between the sales made and the break even point	Total Sales – Break even point
Fixed Costs	Costs which don't change with output (how many items you make or sell)	Rent, Rates, Insurance, Salary
Variable Costs	Costs which do change with output (how many items you make or sell)	Raw Materials, Stock, Wages, Electric used to make product
Total Costs	All of your costs added together	Fixed Costs + Variable Costs
Break-Even Point	When the amount of money spent on making/buying in the product is the same as the money made from selling the product	$\frac{\text{Fixed Costs}}{\text{Selling price per unit} - \text{Variable Costs per unit}}$
Profit	Sales made after the break-even point are a Profit for the company	
Loss	Sales made before the break-even point are a Loss for the company	
Changes to Variable or Fixed Costs	If variable costs decrease, each unit costs less to make. This means they have to sell less to break even. If revenue stays the same they will make a bigger profit	If costs increase, each unit costs more to make. This means they have to sell more to break even. If revenue stays the same
Changes to Sale Price	If the selling price increases the break even point will be lower so they need to sell less. This could affect sales as people won't pay as much so revenue would be less	If they lower the selling price the break even point will be higher so will need to sell more. The lower price might attract more customers and boost their total revenue



Key Facts

Break Even helps a business by showing how many units it needs to sell to cover its costs. It shows when it will start to make a profit and the lowest amount they can sell so they don't make a loss. It can show the margin of safety and if costs or selling price change how that will affect the profit or loss



You must remember the formulas as these are not given in the exam!!

Key Term	Definition	Example and / or Formula
Budget	Shows how much money a business is going to spend & receive over a certain time period	Budgetary control is when you compare the budget figures with the actual figures
Cash Flow Forecast	A cash flow forecast shows what money will come in and go out of the business each month. It shows if they have enough money to pay its debts (bills).	using a cash flow forecast helps to plan for success e.g. to produce new goods / services, invest in new resources, expand or reduce business activities
Cash Inflow	The sources of money coming into the business	Loan, savings, sales revenue
Cash Outflow	The sources and destination of money leaving the business	Rent, electric, gas, interest, stock, rates etc
Profit	Sales made after the break-even point are a Profit for the company	
Loss	Sales made before the break-even point are a Loss for the company	
Reinvestment	If there is a cash surplus you can move your money elsewhere	Extra advertising, Open a new premises, develop a new product, staff training etc.
Cash Deficit	When a business does not have enough money to pay the outflows. Negative number	Solutions – Overdraft, Loan, credit (spreading or delaying the payments)

	December	January	February
Cash Inflows:			
Peter & Sue's Savings	5,000		
Bank Loan	7,000		
Sales Revenue	3,000	000	8,800
Total Cash Inflow	16,300	6,000	8,800
Cash Outflows:			
Purchase of stocks of food	8,000	4,250	3,900
Wages	4,000	3,500	3,700
Interest on bank loan			250
Rent (for 3 months)			
Electricity & gas			
Total Cash Outflow	16,750	8,220	
Net Cash Flow	(450)	(2,220)	
Opening balance	1,000	550	
Closing balance	550	(1,650)	(930)

Total cash inflow is all inflows added together

Total cash outflow is all outflows added together

Net cash flow = Total Cash Inflow - Total Cash Outflow

A number in brackets means it is a minus number i.e. -£1,670

Opening balance = previous months closing balance

Closing balance = Net cash flow + Opening Balance

Benefits of Cashflow	Risks of Cashflow
The timing of when the inflows (revenue) and outflows (expenditure) is known	Late inflows may not be identified
Possible problems are spotted quickly	There may not be enough cash to pay bills/wages
Surplus (spare) cash can be invested	Suppliers may refuse to trade with the business if they have a reputation for non-payment
Expensive items can be bought at the best time or you can look to buy on credit or lease (rent)	An overdraft or loan might need to be arranged which can be costly
The business can plan to expand or reduce activities	The business may run out of money and close
Short Term Problems & Actions	Long Term Problems
Delayed payments from customers – Chase up customers	Too little revenue – try and increase sales/widen product range
Lots of bills arriving at the same time – renegotiate payment dates	Expenditure is too high – reduce costs/change suppliers
Obtain a temporary loan to help	

Impact of timings on Cash Flow

The dates when money is received can be really important when managing cash flow. As budgets will be managed around these dates.

If you pay by cash the business has money immediately. If it is on credit the business has to wait the agreed time (DFS offer 4yrs free credit other businesses might wait 30 days)

If payments come in later than expected this can affect cash flow.

Seasonal businesses (fairgrounds, ice cream van etc) will have more money coming in for part of the year (surplus) and then be in a deficit (not enough money) the rest of it.

To manage inflows a business can;
 Send out invoices promptly and chase them up if not paid
 Avoid giving credit to unknown customers
 Offer discounts if you pay early

To manage outflows a business can;
 Delay some payments
 Reduce stock levels
 Delay a big project
 Make cutbacks to reduce costs

Cost of Sales	Gross Profit
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<p>Cost of Sales are items used to make the product. Eg Jamie makes jeans so his raw materials are Denim, fastenings and zips. If he makes 1500 pairs of jeans and the costs are £8 per pair. Her total costs are £12000 (1500 x 8)</p> <p>Formula: Gross Profit = Revenue – Cost of Sales</p> <p>The cost of sales is taken away from the revenue to find Gross Profit</p>	<p>Gross Profit is how much money is left from selling an item after you have deducted the cost of making it.</p> <p>Formula Gross Profit = Revenue – Cost of Sales</p> <p>If Jamie sold his jeans at £25 his revenue is 1500 x 25 = £37500 - £12000 cost of sales Gross Profit = £25500</p>
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Impact of Positive Gross Profit	Impact of Negative Gross Profit
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There is money to pay for the expenses	There is no money to pay expenses/wages without getting an overdraft or loan which will increase costs
There might be money left over for new equipment/expansion	The Cost of Sales is too high – could this be reduced by changing supplier
The cost of Sales isn't too high	Sales revenue is too low – more goods must be sold

Enough goods are being sold to produce a profit	
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Net Profit	Financial Statements
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<p>Net Profit is how much money is left after you have deducted all the costs of the business from your gross profit.</p> <p>Formula Net Profit = Gross Profit – Expenditure</p> <p>If Jamie sold his jeans at £25 his revenue is 1500 x 25 = £37500 - £12000 cost of sales Gross Profit = £25500</p>	<p>Financial statements show whether or not a business is doing well. Their purpose is to record the financial activities of the business. Provide an overview of the financial position and whether the business is well managed and successful.</p> <p>They are read by Shareholders, competitors, managers, employees, suppliers, the government and customers</p> <p>There are 2 types – Income statement (profit and loss account) and statement of financial position (balance sheet)</p>
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Impact of Positive Net Profit	Impact of Negative Net Profit
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Gross Profit is positive	Gross Profit is low or negative
There is money left over for new equipment/expansion	Expenditure is too high
Expenditure is less than gross profit	The Business is losing money

Assets – items owned by the business and worth money	Liabilities – debts or obligations the business has
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Income Statement

The top part is the **TRADING ACCOUNT**. It shows the Gross Profit

Formula:

$$\text{Gross Profit} = \text{Revenue} - \text{Cost of Sales}$$

The cost of sales is taken away from the revenue to find Gross Profit

The next part lists and adds up the expenses

The final part calculates the **NET PROFIT** by taking away the total expenses from the gross profit

Formula

$$\text{Net Profit} = \text{Gross Profit} - \text{Expenditure}$$

Working Capital (**Net Current Assets**) is the money the business needs every day to trade and pay its bills. **Current Assets** need to be more than **Current Liabilities**. This means you have enough money to pay your bills and have money left over.

$$\text{Working Capital} = \text{Current Assets} - \text{Current Liabilities}$$

Trading and Profit and Loss Account For the Year ending 31st December		
	£000	£000
TURNOVER		300
COST OF SALES		
Opening Stock	40	
PLUS Purchases	120	
	<u>160</u>	
LESS Closing stock	30	
		<u>130</u>
GROSS PROFIT		170
ADMINISTRATIVE EXPENSES		
Wages	50	
Insurance	2	
Rent	30	
Rates	11	
Telephone	4	
Advertising	11	
Depreciation	5	
Computer Costs	10	
Light and Heat	1	
		<u>124</u>
NET PROFIT		<u>46</u>

ASSETS

Assets are items the business owns or are owed to the business.

Fixed Assets – Something of worth that lasts a long time. For example, Vehicle, Computer, machinery

Current Assets – Assets which can be easily converted into cash. For example, **stock** which can be sold to customers, **Cash** received from customers and Trade Receivables (**DEBTORS**) This is customers who owe the company money (like a buy now pay later)

Statement of Financial Position

The purpose of a balance sheet is to show the financial position of the business at a certain time. It shows how the business spends its money (assets & liabilities) and how it is funded (capital)

The Shareholders funds section shows Capital – money from internal (shareholders) & external sources (bank loans).
Retained profit – previous profits the owner has kept in the business.

LIABILITIES

Liabilities are **DEBTS OWED** by the business. Examples of these are;

Current Liabilities – Debts that need to be paid soon. This can include Trade Payables (**CREDITORS**) people you owe money to such as suppliers of your stock, **Overdrafts** or Short term **bank loans**.

Long-term Liabilities – Funds borrowed over a long time such as a mortgage.

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Balance Sheet as at 31 July

	£000	£000	£000
Fixed Assets			
Equipment & Fittings			25
Vehicles			<u>15</u>
			40
Current Assets			
Closing Stock		15	
Debtors		5	
Cash at Bank		<u>10</u>	
		30	
Current Liabilities			
Creditors		<u>5</u>	
Net Current Assets			<u>25</u>
Net Assets			65
Financed by:			
Capital			45
Net Profit			<u>20</u>
			65

Analysing an Income Statement (profit & loss account)

Businesses need to increase profits if their income statement /profit & loss account shows they are low.

They can do this by increasing revenue (sales) or reducing costs.

To increase Gross Profit they can negotiate cheaper prices with suppliers, use different materials, sell more products or increase the selling price if possible.

To increase Net Profit you can reduce expenses like changing utility supplier, move premises, reduce staff or reduce pay rates

Negatives

If you buy cheaper raw materials it may reduce the quality of the goods.

Increasing selling prices could mean fewer sales

Analysing a statement of financial position (balance sheet)

When analysing a Balance sheet look at each of the figures given.

Stock – too high? Sell it Too low? Buy some more

Trade Receivables (debtors) – If high then collect your payments from your debtors

Cash – if low then chase up debts to get the money in or sell off slow-moving stock

Trade payables – if too high suppliers might stop providing your products

Overdraft – this costs money in bank charges – get rid asap!

Working Capital – must be enough to pay the day to day bills!

Impact of Negative Gross Profit

Lowering staff wages could lose staff

More advertising can reduce

