Kibworth Mead Academy

GCSE Business Studies

Unit 5: Finance

Revision Guide

Name:	Target grade:

Paper 2: Operations, Finance and Influences on Business		
Content overview	**Assessment overview**	
Operations **Finance** Influences on Business	Business 2 80 marks 1 hour 30 minute paper	50% of total GCSE

Topic	Content
5.1 The role of the finance function	▪ The purpose of the finance function ▪ The influence of the finance function on business activity
5.2 Sources of finance	▪ The reasons businesses need finance ▪ Ways of raising finance ▪ How and whydifferent sources of finance are suitable for new and established businesses
5.3 Revenue, costs, profit and loss	▪ The concept of revenue, costs and profit and loss in business and their importance in business decision-making ▪ The different costs in operating a business ▪ Calculation of costs and revenue ▪ Calculation of profit/loss ▪ Calculation and interpretation of profitability ratios ▪ Calculation and interpretation of average rate of return
5.4 Breakeven	▪ The concept of break-even ▪ Simple calculation of break-even quantity ▪ The usefulness of break-even in business decision making
5.5 Cash and cash flow	▪ The importance of cash to a business ▪ The difference between cash and profit ▪ The usefulness of cash flow forecasting to a business ▪ Completion of cash flow forecasts

Complete the checklist below to rate your understanding of each of the topics in Unit 5: Finance

Tick the relevant column to identify your learning and understanding of each of the areas studied.

Unit 5: Finance			
5.1 The Role of the Finance Function			
The purpose of the finance function ○ Providing financial information, support business planning and decision making			
The influence of the finance function on business activity			

5.2 Sources of Finance			
The reasons businesses need finance ○ Establishing a new business, funding expansion, to run the business, recruitment, marketing			
Ways of raising finance ○ Loan, overdraft, trade credit, retained profit, sale of assets, owners' capital, new partner, share issue, crowd funding			
How and why different sources of finance are suitable for new and established businesses			

5.3 Revenue, Costs, Profit and Loss			
The concept of revenue, costs and profit and loss in business and their importance in decision making			
The different costs in operating a business ○ Fixed, variable, total			
Calculation of costs and revenue			
Calculation of profit/loss ○ Gross profit, net profit			
Calculation and interpretation of profitability ratios ○ Gross profit margin, net profit margin			
Calculation and interpretation of average rate of return			

5.4 Breakeven

The concept of breakeven ○ Total costs = total revenue			
Simple calculation of breakeven quantity			
The usefulness of breakeven in business decision making ○ Informs marketing and planning decisions			

5.5 Cash and Cash Flow			
The importance of cash to a business ○ Providing liquidity, enables business to meet short term debts/expenses			
The difference between cash and profit			
The usefulness of cash flow forecasting to a business ○ Planning tool, anticipates periods of cash shortage, enable remedies to be put in place for shortages, provides targets			
Completion of cash flow forecasts			

Glossary/Key Terms

In your exam you will be required to explain the meaning of a range of key terms.

In most cases 2 marks are available for demonstrating full understanding of the key term and 1 mark for providing a relevant example.

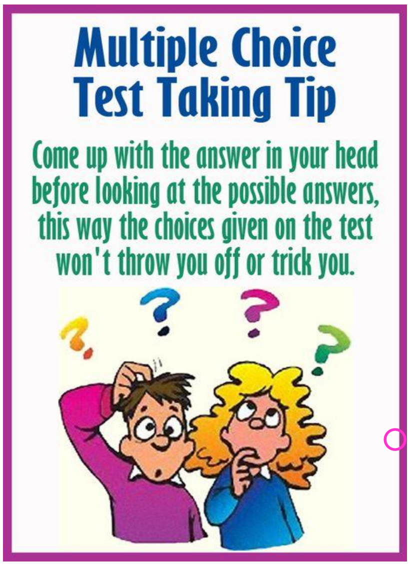
Complete the glossary below so that you have a full set of key term definitions with examples.

Key Term	Explanation	Example
Average rate of return (ARR)		
Break-even forecast		
Break-even quantity		
Cash		
Cash flow forecast		
Closing balance		
Crowd funding		
Expenditure		
Expenses		
Finance function		
Financial information		
Fixed costs		
Gross profit		
Gross profit margin		

Income		
Interest		
Liquidity		
Loans		
Loss		
Margin of safety		
Net cash flow		
Net profit		
Net profit margin		
Opening balance		
Overdraft		
Owners’ capital		
Profit		
Profitability ratios		
Retained profit		
Revenue		
Sale of assets		
Share issue		

Taking on a partner		
Total costs		
Total inflow		
Total outflow		
Trade credit		
Variable costs		

Exam 'Top Tips'



Read the question carefully and decide on the answer.

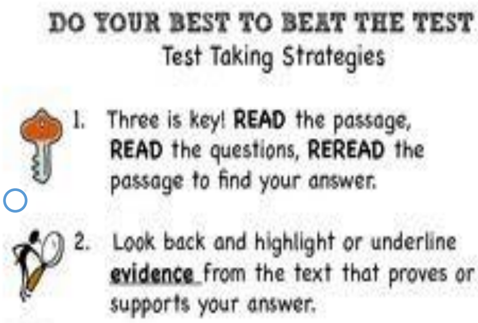
Check the possible options and cross out the ones that are **definitely wrong!**

"Be specific about what the product or service actually is. Use actual competitor names too"

Read the question and the information very carefully. Some of your answers will come directly from the text!

Highlight/underline key information in the text

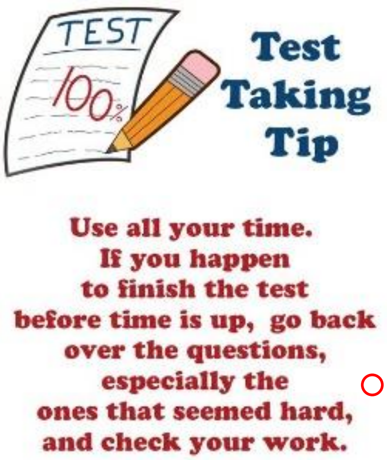
"Follow the correct structures, you have been given them for a reason"


DO YOUR BEST TO BEAT THE TEST
Test Taking Strategies

1. Three is key! **READ** the passage, **READ** the questions, **REREAD** the passage to find your answer.
2. Look back and highlight or underline evidence from the text that proves or supports your answer.

"Where the question asks for TWO reasons/example/benefits, make sure you include TWO"

"If the question doesn't tell you how many to include, look at the number of marks available"



If you finish your paper before the 90 minutes are up

Check, check and check again!
Ask yourself: So? Why? How? If?

Exam Structures

Follow each of the structures below when answering your exam questions

Explain [2 marks]
Point
Explain *2 strands of information using a connective*

Explain [4 marks]
Point
Explain *2 strands of information using a connective*
Point
Explain *2 strands of information using a connective*

Analyse [3 marks]
Point
Explain *2 strands of information using a connective*
Impact

Analyse [6 marks]
Point
Explain *2 strands of information using a connective*
Impact
Point
Explain *2 strands of information using a connective*
Impact

Recommend [3 marks]
Point
Explain *2 strands of information using a connective*
Impact
However

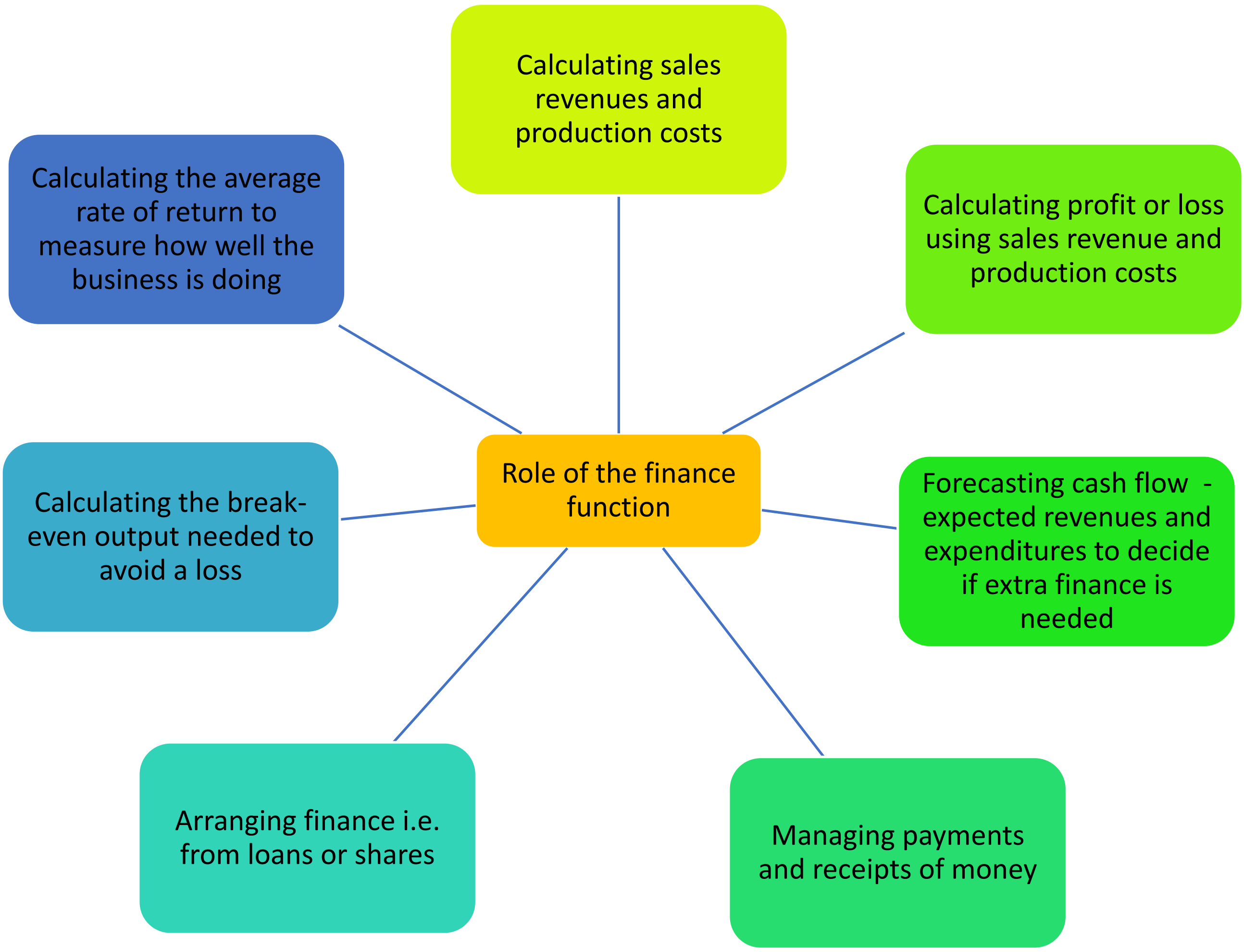
Evaluate/Discuss [7/9 marks]
Point 1
Explain positive *2 strands of information using a connective*
Impact
However
Explain negative *2 strands of information using a connective*
Impact
Point 2
Explain positive *2 strands of information using a connective*
Impact
However
Explain negative *2 strands of information using a connective*
Impact
In conclusion the business should.....
The most important reason for this is.......because.....
While they do need to consider.....
I would still recommend.....for the business because.....

5.1 The role of the Finance Function

Specification content	What you should know
The purpose of the finance function	✓ Providing financial information, support business planning and decision making
The influence of the finance function on business activity	✓ Monitoring cash flow can impact on other business activities - procurement may have to buy less stock if goods are not sold and there are cash flow problems identified by the finance function

Purpose of the finance function and influence of the finance function on business activity

The term 'role of the finance function' refers to the jobs that are done by a finance department in a business and these are summarised in the figure below. The work may be done by a department in a large company or by an individual worker in a small business.



The work of the finance function is important for decision making. For example, a business may want to bring out a new product. The finance function would provide financial information about cash flow, spending on marketing, break-even, production costs, profits and a comparison of the costs of different types of selling, such as online or through a shop. Other departments will also influence decision making, for example, the production department may suggest the number and types of workers needed and the machinery required. This illustrates how departments in a business are interdependent (they are linked together!).

5.2 Sources of finance

Specification content	What you should know
The reasons businesses need finance	✓ Establishing a new business, funding expansion, to run the business, recruitment, marketing
Ways of raising finance	✓ Loan, overdraft, trade credit, retained profit, sale of assets, owners' capital, new partner, share issue, crowdfunding
How and why different sources finance are suitable for new and established businesses	✓ Analyse and evaluate the different ways of raising finance

Reasons businesses need finance

Some of the reasons businesses need finance are summarised in the table below.

Need for finance	Explanation
Establishing a new business	When a business starts up, it will need to buy items before it can produce or sell anything. For example, it may need to buy or rent a factory, office or shop as well as furniture and machinery
Funding expansion	If a business decides to increase its sales by producing and selling more goods, it may need to pay for a larger factory, shop or office, along with the furniture and machinery for these. It may need to buy more materials or stocks
Recruitment	A business will need to recruit workers when it starts up, when it expands and when workers leave and new ones are employed. It costs money to advertise jobs and select workers. Wages and salaries of new staff also need to be paid
Marketing	Marketing campaigns need to be funded. Advertising and public relations, for example, cost money
Running the business	All businesses need finance for day-to-day costs such as buying materials, paying expenses such as heating and paying wages

In the table below, match the reason for needing finance in the left hand column with the example of that reason in the right hand column.

Reason for needing finance
Starting up a new business
Replacing old machinery, equipment and premises
Internal growth
External growth - the takeover or acquisition of another company
Day-to-day expenses - dealing with cash flow problems
Development purposes - research and development

Example
A pharmaceutical company seeking to develop a new drug to treat cancer
A person setting up a new business installing and maintaining burglar alarms
A theme park that is only open from Easter to October needs money during the closed season for maintenance and promotional activities
Buying new computer equipment to replace old computers that have been in use for several years
Buying new manufacturing equipment as a result of increased demand for products
Walmart, the USA retailer, has taken over Jet.com, an online retailer, which is the main challenger to Amazon

Ways of raising finance

All businesses need to raise finance. The table below summarises the advantages and disadvantages of different sources of finance.

Sources of finance	Advantages	Disadvantages
Owners capital The owners' savings are invested	▪ No need to repay ▪ No interest to pay ▪ Does not affect ownership and control	▪ Owner risks savings ▪ Owner may not have enough in savings ▪ Leaves the owner without any money for personal emergencies
Retained profit Profit not distributed to the owners or shareholders	▪ No need to repay ▪ No interest to pay	▪ Business may not have made any/enough profit ▪ Owners will not get profit as income

Sale of assets Goods owned by the business that can be sold to raise money	▪ No need to repay ▪ No interest to pay ▪ Good if selling off old equipment or stock	▪ May be difficult to sell ▪ May take time to sell ▪ Make sell something that you later need
Overdraft A bank makes available to a business, more money than they have in their account	▪ Meets short term cash flow problems ▪ Interest is only paid on the amount owed ▪ Repayment is only due when the business closes or the overdraft is no longer needed	▪ Interest is charged for each day money is owned, which can be expensive
Trade credit A business sells goods after agreeing to pay for them at a later date	▪ The business can have goods to sell before paying for them, via a credit period (usually 30 days but can be up to 90 days) ▪ No interest if repaid within agreed time limit ▪ Can help with a cash flow problem	▪ Goods must be paid for even if they do not sell ▪ Interest is charged if payment is late
Taking on a new partner The new partner invests some of their savings in the business	▪ The new partner may bring new skills ▪ No need to repay ▪ No interest to pay	▪ The existing owner(s) will have to give the new partner a say in the running of the business and a share of the profits ▪ Partnerships can take on new partners. Sole traders can also do so but only if they become a partnership
Loan A set amount of money borrowed from the bank for a set period of time	▪ Repayment is made in fixed sums over a period of time and usually paid monthly ▪ The money is available immediately	▪ Interest must be paid ▪ The business may need to give the lender security
Share issue New shares are sold to raise more money	▪ New investors can contribute a lot of money to the business ▪ No need to repay ▪ No interest to pay	▪ The existing owner(s) will have to give the new shareholders a say in the running of the business and a share of the profits ▪ Shares can only be sold by limited companies, not by sole traders and partnerships
Crowdfunding Money is donated or invested by sponsors or people invest to become part-owners of the business	▪ New supporters can contribute a lot of money to the business through loans, donations or investing as part-owners ▪ No need to repay ▪ No interest to pay	▪ Interest will be paid if the money is raised through a loan ▪ Ownership will be shared if the money is raised through investment

For each of the statements given in the table below, identify whether they are true or false.

Statement	True	False	Statement	True	False
A loan has to be repaid with interest			New partners are usually easy to find		
Shareholders are part-owners of a business			An overdraft is a cheap way of borrowing money for long term projects		
Banks will always lend a business money			Selling assets is a quick way of raising finance		

You also need to know which sources of finance are typically used to provide short-term finance and which are used for medium and long term finance. Remember! Some sources of finance can be used under more than one time period depending on the circumstances.

Short term finance
Up to 12 months

- Owners' capital
- Sale of assets
- Trade credit

Medium term finance
1-5 years

- Owners' capital
- Sale of assets
- Retained profit
- Bank loan
- Crowdfunding

Long term finance
5 years or more

- Owners' capital
- Sale of assets
- Retained profit
- Bank loan
- Crowdfunding
- Taking on a new partner
- Share issue

How and why different sources of finance are suitable for new and established businesses

Businesses need to decide which of the sources of finance available to them they should use. To make this decision, they will evaluate the advantages and disadvantages of internal finance and external finance by asking a series of questions. Once they have the answers to these questions, they can make their decision.

The figure below gives some examples of the type of questions a business might ask itself.

Internal or external?

- Do we need external finance or can we finance it ourselves (from money we already have)?
- Do we have savings of retained profit to use or assets such as machinery we can sell? If not, external finance is needed

Term of finance

- How long do we need the finance for?
- Is it just for the short term i.e. to help with cash flow?
- Will we need the money to pay for a long term investment plan such as expanding the business over 10 years?

Availability

- Is this source of finance available to our type of business?
- Is it possible for our type of business to take on a new partner or to sell new shares?

Control/ownership

- Do we want to keep control over the business as owners?
- Will it help if other people become owners, providing more money and, perhaps, more expertise?

5.3 Revenue, Costs, Profit and Loss

Specification content	What you should know
The concept of revenue, costs and profit and loss in business and their importance in business decision-making	✓ Will there be enough revenue available to fund an expansion? Will the expansion have to be postponed
The different costs in operating a business	✓ Fixed, variable, total
Calculation of costs and revenue	✓ Fixed costs, variable costs, total costs ✓ Percentages, percentage changes, averages
Calculation of profit/loss	✓ Gross profit and net profit
Calculation and interpretation of profitability ratios	✓ Gross profit margin and net profit margin, interpretations of the calculations
Calculation and interpretation of average rate of return	✓ Average rate of return, interpretation of the calculations

The concept of revenue, in business and their importance in business decision-making

Total revenue is the sum of money a business earns from all the sales it makes. Revenue is important for businesses because it pays for costs, is a measure of success and, along with costs, determines profit.

Revenue influences business decision making in several ways. For example, if a business wished to increase its revenue, it could opt for one or more of the following:

- Increase the price of the product - this will work if customers do not switch to a cheaper competitor and is likely to succeed if there are few or no competitors

- Reduce the price to increase sales - this will work if sales rise, perhaps if there are lots of competitors who do not lower their prices
- Increase in sales by increasing:
    - Advertising (targeted correctly and sending the right message)
    - Producing more by having a new factory or shop or buying a competitor business
    - Selling a wider range of products (if customers want to buy these)

However, sometimes a business may not want to make as much revenue as possible:

- The owner(s) do not want to expand, perhaps to avoid sharing control
- The business may want to sell to a niche market, for example, selling only to very wealthy people, so they can charge a high price to make their product exclusive

The concept of costs, in business and their importance in business decision-making AND the calculation of costs

Costs are necessary for production to take place and, along with revenue, they determine how much profit a business will make.

A business may want to minimise its costs to help it to:

- Increase profits
- Reduce prices to become more competitive without cutting profits
- Save money in order to expand or to update machinery

Costs may be reduced by:

- Employing new technology instead of workers (although there may be costs in making workers redundant)
- Finding cheaper supplies of materials or goods to sell (although businesses would need to ensure quality and reliability)
- Asking a supplier to reduce its prices or asking workers to take a pay cut. Although suppliers and workers will not want to do this, they may have no alternative but to agree if they could lose sales or their jobs.

Sometimes a business might not need to minimise its costs because, for example, it makes a high quality product and it knows that its customers are prepared to pay a high price or it does not have any competitors.

There are different types of costs that you need to be aware of:

- Fixed costs - these are costs that ***do not*** change when the business changes the amount it produces i.e. rent and rates
- Variable costs - these are costs that ***do*** change when the business changes the amount it produces i.e. raw materials

For each of the following, identify whether they are a fixed or variable cost

Cost	Fixed	Variable
Insurance		
Wages		
Rent		
Heating		
Business rates		
Raw materials		

Example calculations for variable costs and total costs are shown below

Total variable costs:

Cost of materials per product x number of products sold £3 per product x 6,000 = £18,000

Total variable costs =£18,000

Total costs:

Total fixed costs (£12,000) + total variable costs (£18,000) = £30,000

The concept of profit and loss in business and their importance in business decision-making AND the calculation of profit and loss

The concept of profit, at its simplest, is that when the total revenue of a business is more than its total costs of production, the business has made a profit.

Profit:

Total revenue of the business: £22 million
Total costs: £12 million

Profit: total revenue - total costs £22 million - £12 million = £10 million profit

Loss:

Total revenue of the business: £56 million
Total costs: £80 million

Profit/loss: total revenue - total costs   £56 million - £80 million = -£24 million profit

The examples below show how to calculate the gross profit and the net profit of a business

Gross profit:

Sales (total revenue) - cost of sales = gross profit

Note: the cost of sales is the cost of buying in the goods the business sells, or the costs of producing goods

Sales (total revenue): £35,000   Cost of sales: £15,000

£35,000 - £15,000 = £20,000 gross profit

Net profit:

Gross profit - expenses = net profit

Note: expenses are the costs of running the business

Gross profit: £20,000   Expenses: £12,000

£20,000 - £12,000 = £8,000 net profit

Calculation and interpretation of profitability ratios

The gross profit margin is about comparing the total revenue earned by the business with the cost of the sales it makes.

The net profit margin is about comparing the gross profit the business earns with its expenses.

Although profit and loss figures are useful, gross and net profit margins give a better indication of how well a business is performing. They can help the business to know where its performance can be improved and whether action needs to be taken. Gross and net profit margins are discussed in the table below.

Performance	Gross profit margin	Net profit margin
Improving performance	Gross profit margin rises: 2017 = 44% 2018 = 57.1%	Net profit margin rises: 2017 = 18% 2018 = 22.8%
Reasons for improvement	▪ Total revenue rose faster than cost of sales ▪ Total revenue fell but costs of sales fell more ▪ Total revenue rose and cost of sales fell	▪ Gross profit rose faster than expenses ▪ Gross profit has fallen but expenses fell more ▪ Gross profit rose and expenses fell

Performance	Gross profit margin	Net profit margin
Worsening performance	Gross profit margin falls: 2017 = 64% 2018 = 57.1%	Net profit margin falls: 2017 = 18% 2018 = 12.8%
Reasons for worsening performance	▪ A fall in total revenue and a rise in the cost of sales ▪ A rise in total revenue but a bigger rise in cost of sales ▪ A fall in total revenue but a smaller fall in cost of sales	▪ A fall in gross profit and a rise in expenses ▪ A rise in gross profit but a bigger rise in expenses ▪ A fall in gross profit but a smaller fall in expenses
Possible actions	▪ Increase total revenue by better marketing, for example: ○ Raise (or reduce) price ○ Increase advertising ○ Sell in new markets i.e. abroad ○ Increase the range of products sold ▪ Reduce cost of sales by, for example: ○ Negotiating a lower price from suppliers ○ Buy from cheaper suppliers	▪ Increase total revenue by better marketing, for example: ○ Raise (or reduce) price ○ Increase advertising ○ Sell in new markets i.e. abroad ○ Increase the range of products sold ▪ Reduce expenses by, for example: ○ Reducing the wage bill (reducing hours, cutting hourly pay, replacing labour with machines) ○ Saving on heating and lighting bills

It is also worth remembering that a business may compare its gross and net profit margins against other similar businesses to decide if it is performing well enough and if any action is needed.

Calculating and interpretation of average rate of return (ARR)

Average rate of return is used to judge whether investments in the business by its owners is worthwhile - will it give a good enough return? ARR is a forecast - it is based on the *expected*profit the investment will make, compared with the cost of the investment.

There are three stages in the calculation of ARR which are shown in the table below. The example below uses an investment by a business in a piece of machinery costing £300,000, used over a period of three years - this is the life of the investment.

Calculation	Formula	Example
1. Calculate the total profit from the investment over the life of the investment	Total revenue (from the investment) - cost of the investment = profit over the life of the investment	£570,000 - £300,000 = £270,000
2. Calculate the annual average profit per year	$\frac{\text{Total profit}}{\text{Life of the investment (years)}}$ = average annual profit	$\frac{£270,000}{3}$ = £90,000
3. Calculate the ARR	$\frac{\text{Annual average profit}}{\text{Cost of investment}} \times 100$ = annual rate of return	$\frac{£90,000}{£300,000} \times 100$ = 30%

Businesses use ARR to:

- Compare different investments i.e. machine A costs £300,000 and gives an ARR of 30%, while machine B costs £400,000 and products an ARR of 42%. If the business can afford the extra cost of machine B, this is a better investment because it gives a better average rate of return.

- Compare an investment with saving i.e. a business could save £300,000 in a savings account and receive 5% interest or it could invest its £300,000 and receive an ARR of 30%. The ARR shows that it would be better to invest, but if the ARR of the investment was only 3%, it would be better to put the money into a savings account.

5.4 Break-even

Specification content	What you should know
The concept of break-even	✓ Total costs = total revenue
Simple calculation of break-even quantity	✓ Total fixed costs ÷ (price - variable costs per unit)
The usefulness of break-even in business decision-making	✓ Informs marketing and planning decisions i.e. setting production levels or deciding on a pricing strategy

The concept of break-even and simple calculation of break-even quantity

A business will break even when the revenue it earns from sales is equal to the cost of selling that output. The output at which revenue is equal to cost is called the break-even quantity. The business is neither making a profit or a loss. The concept can be applied to a business as a whole or to just one product that the business sells.

The break-even output can be calculated in three ways:

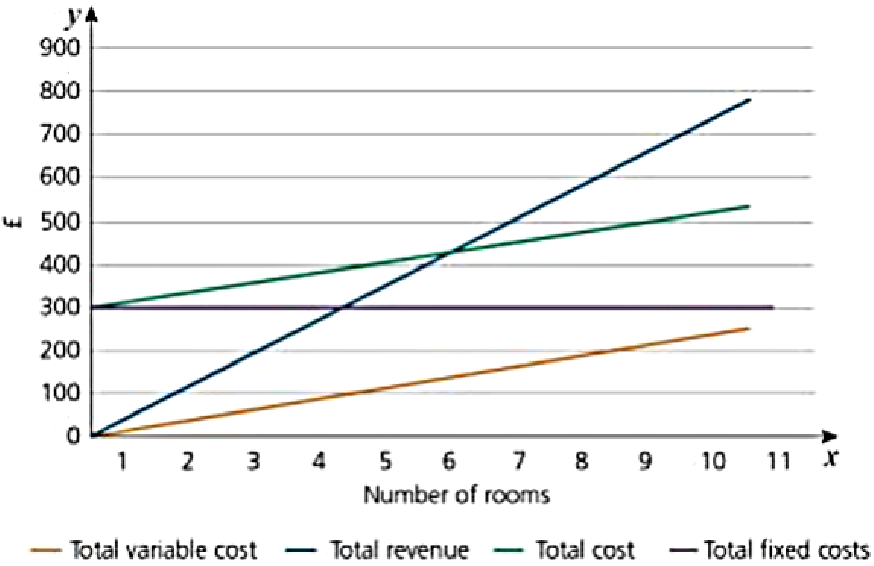
Method 1: Calculating break-even from a table of output, revenue and cost figures

Output - cans of deodorant	Total variable costs (£)	Total fixed costs (£)	Total costs (£)	Total revenue (£)
0	0	8,000	8,000	0
2,000	2,000	8,000	10,000	4,000
4,000	4,000	8,000	12,000	8,000
6,000	6,000	8,000	14,000	12,000
8,000	**8,000**	**8,000**	**16,000**	**16,000**
10,000	10,000	8,000	18,000	20,000
12,000	12,000	8,000	20,000	24,000
14,000	14,000	8,000	22,000	28,000
16,000	16,000	8,000	24,000	32,000
18,000	18,000	8,000	26,000	36,000
20,000	20,000	8,000	28,000	40,000

The table above shows the costs and revenues for a business producing cans of deodorant, which it sells at £2 each. The variable costs are £1 per can and the fixed cost of production is £8,000.

To find the break-even output, look down the total cost and total revenue columns to see at which output the two are equal. In this example, this is at an output of 8,000 cans.

Method 2: Calculating break-even from a graph



The graph shows the revenue and costs per week of the Durham Guest House. The variable cost per room is £25 and the selling price per room is £85. The number of rooms the Durham Guest House must sell each week to break even is 6.

This can be found where the total revenue line crosses the total cost line.

Method 3: Calculating the break-even output using a formula

The formula for calculating break-even and an example of the calculating are shown below:

$$\text{Break-even output} = \frac{\text{total fixed costs}}{\text{price} - \text{variable cost per unit}}$$

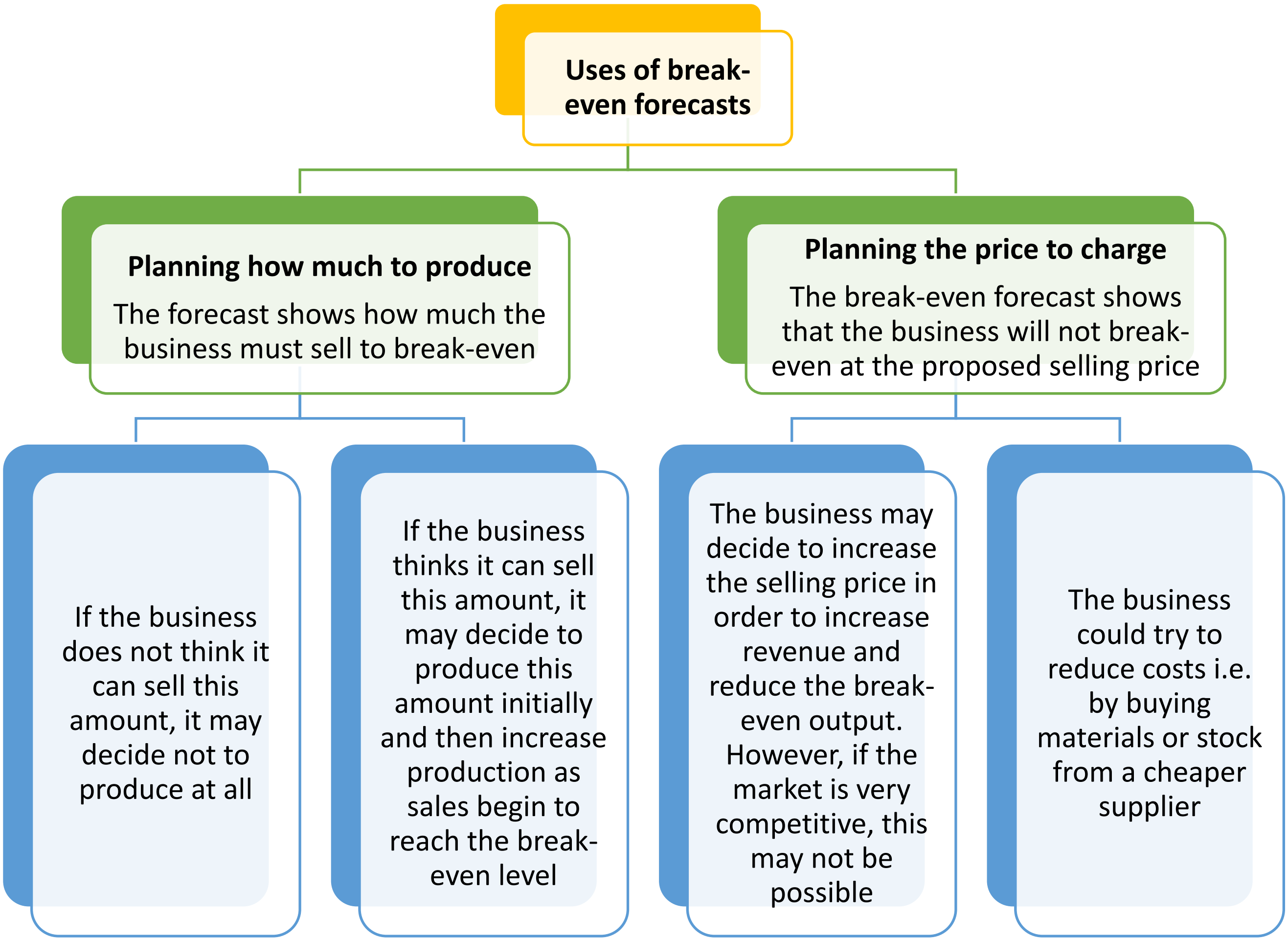
A business makes and sells earphones. It sells each set of earphones for £20 (price). The variable cost is £8. The fixed cost is £30,000. The calculation of break-even is shown below:

$$\frac{£300{,}000}{(£20-£8)} = \underline{2{,}500}$$

The business must sell 2,500 sets of earphones to break-even.

Usefulness of break-even analysis in business decision making

Break-even forecasts can be used by businesses to plan how much to produce or how much to charge as shown in the diagram below.



There are problems with break-even forecasting so businesses need to take care when making decisions based on them. The problems include:

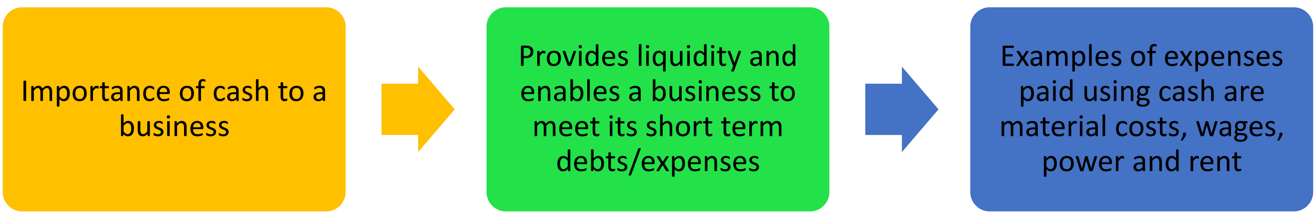
- It is only a forecast, a prediction, so things may change in the future
- The business may not be able to sell at the price planned. New competition in the market may force the price down or demand may be lower at that price, perhaps because incomes have fallen or the price is simply too high
- Higher than forecast costs may occur if prices of materials or stocks rise

5.5 Cash and cash flow

Specification content	What you should know
The importance of cash to a business	✓ Providing liquidity, enables businesses to meet short-term debts/expenses
The difference between cash and profit	✓ Cash is a liquid asset that represents the money available to pay for things ✓ Profit is the difference between revenue and total costs
The usefulness of cash flow forecasting to a business	✓ Planning tool, anticipates periods of cash shortage, enables remedies to be put in place for shortages, provides targets
Completion of cash flow forecasts	✓ Total costs, total revenue, net cash flow, opening balance, closing balance

Importance of cash to a business and the difference between cash and profit and the usefulness of cash flow forecasting to a business

Cash is money that a business has on its premises or in its bank account. The figure below explains the importance of cash to a business.



Profit is the difference between sales revenue and production costs. Remember that cash and profits are not the same. A business can have a lot of cash but not make a profit, equally it can be short of cash but still make a profit. The table below explains why cash flow forecasts are useful to a business.

Use	Explanation
Planning tool	▪ A cash flow forecast is a plan which will help a business know if it will have liquidity. Liquidity is when a business can pay its bills ▪ A bank manager who sees a well-thought out cash flow forecast is more likely to give a business a loan, especially if there is a positive cash flow
Anticipating periods of cash shortages	▪ A cash flow forecast might show that the business will have a cash shortage at some time - it does not have liquidity. Knowing this, the business will be able to plan how to deal with this
Dealing with a cash flow shortage when the business has a negative cash flow (it does not have liquidity)	▪ A shortage can be dealt with by: ○ Arranging for finance (usually an overdraft. Though this will mean paying interest) so the business can pay its bills (i.e. wages, suppliers etc) to continue production ○ Trying to reduce spending or increase revenue to avoid the shortage
Providing targets	▪ A business may set a target for cash held so it knows it can pay bills during a period of negative cash flow

Note: cash flow forecasts are not always accurate. Sales may not be as high as expected, the price lower and the costs higher. Sales may be affected by the weather or changes in the economy (i.e. changes to peoples employment and incomes). Costs may rise or fall depending on economic conditions.

Completion of cash flow forecasts

The table below shows the cash flow forecast for a convenience shop in Bowburn. Its cash flow income comes from selling groceries and newspapers and renting out two apartments above the shop. Its cash outflow is payments for stock, heating and lighting bills, workers' wages and interest repayments due each month.

Cash flow forecast - convenience shop				
	January £	**February £**	**March £**	**April £**
Cash inflow				
Sales	100,000	80,000	60,000	70,000
Rental income	10,000	10,000	10,000	10,000
Total inflow	110,000	90,000	70,000	80,000
Cash outflow				
Stock	50,000	80,000	60,000	40,000
Energy costs	5,000	10,000	5,000	5,000
Wages	10,000	30,000	20,000	10,000
Interest and loan repayments	10,000	15,000	10,000	5,000
Total outflow	75,000	135,000	95,000	60,000
Net cash flow	35,000	-45,000	-25,000	20,000
Opening balance	25,000	60,000	15,000	10,000
Closing balance	60,000	15,000	-10,000	10,000

The notes below explain how the cash flow statement is drawn up:

1. Cash that flows in is added up and the total for each month is put in the 'total inflow' row
2. Cash that flows out is added up and the total for each month is put in the 'total outflow' row
3. Total outflow is deducted from total inflow each month and this is the 'net cash flow'.
4. The opening balance is the cash the business has at the stat of the month
5. Net cash flow is added to the opening balance if it is a positive or deducted if it is a negative. This gives the 'closing balance'. This becomes the opening balance for the next month.

From the cash flow statement above, we also know the following:

1. For January and April, the shop is forecasting a positive cash flow.
2. For February and March the shop is forecasting a negative cash flow.
3. For January, February and April, the shop is forecasting a positive closing balance. The shop has cash at the end of the month.
4. For March the shop is forecasting a negative closing balance. This means the business does not have enough cash to pay its bills. It could finance this by using an overdraft or it could delay payment of some of its bills to avoid this. Note that a negative cash flow may not be a problem if it is temporary.

Using the words below, fill in the gaps to complete the paragraph

Cash flow forecast is only an ___________________ of the amount of income and _________________________- which a business expects. The main purpose of the calculation is to estimate when the business may have ______________________ or too little cash. It does not calculate _____________________________. When a shortage of cash, to pay bills, is expected, the business may need to change its ________________________ so that costs are reduced and attempts are made to _______________________ its income, without sufficient cash, the business may go _______________________ not because it is unprofitable, but because it has _______________________. Short-term forecasts are likely to be more ______________________ than long-term forecasts.

estimate **plans**

increase **accurate**

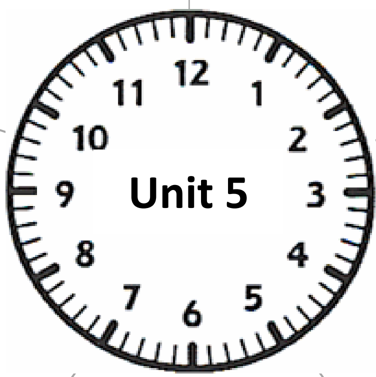
run out of money **out of business** **too much**

profit **expenditure**

Revision Clocks

Cash and cash flow

The role of the finance function



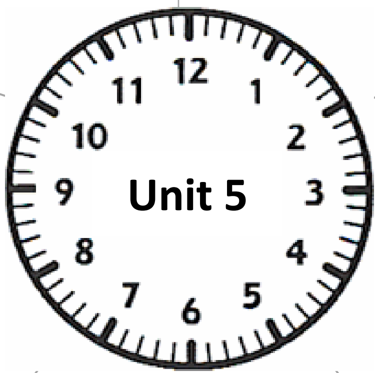
Break-even

Sources of finance

Revenue, costs, profit and loss

Cash and cash flow

The role of the finance function



Break-even

Sources of finance

Revenue, costs, profit and loss

DO YOUR BEST TO BEAT THE TEST
Test Taking Strategies

1. Three is key! **READ** the passage, **READ** the questions, **REREAD** the passage to find your answer.
2. Look back and highlight or underline evidence from the text that proves or supports your answer.

Possible Practice Exam Questions

Answer each of the following exam style questions. Use the structures on p10 to help you.

DO YOUR BEST TO BEAT THE TEST
Test Taking Strategies

1. Three is key! **READ** the passage, **READ** the questions, **REREAD** the passage to find your answer.
2. Look back and highlight or underline evidence from the text that proves or supports your answer.

Scruffs

Xander started Scruffs from his home, selling beard oil online and using social media to promote it. He took a risk in sending some oil to celebrities who then endorsed the oil on their Instagram accounts.

Xander uses a subscription model, customers pay £6 a month and he delivers a different oil to them every month. After 6 months he had 1000 customers signed up. Because he still operates from home, he has low fixed costs, £1,500 a month. Each bottle of oil costs £1.20 for the oil, £0.50 for the bottle and postage of £1.55.

Xander has built up a good cash reserve and his cash flow for next year looks positive so he has thought of expanding into male make-up. He has been offered an investment in an American firm, War Paint, who wants to enter the UK market.

War Paint made a gross profit of £120,000 last year after making sales of £225,000.

While Xanderhas some money it is not enough so he is considering taking on a partner, although he realises this will mean losing control of the business and sharing the profits, it should be a quick way to get the money. That said, his friend suggested that he uses his social media platform to crowdfund the expansion.

1. State one variable cost a business may have. . [1]

____

____

2. Explain what break-even is. [2]

____

____

____

3. Calculate Scruff's monthly break-even point. [3]

Answer: ____________________________________

4. Analyse one use of break-even to Scruffs. [3]

____

____

____

____

5. Calculate the gross profit margin for War Paint. [3]

Answer: ____________________________

6. Analyse one advantage to Xander of using crowdfunding for the expansion. [3]

____

____

____

____

7. Analyse one disadvantage to Xander of using crowdfunding for the expansion. [3]

____

____

____

____

8. Recommend whether Xander should use crowdfunding or take on a partner to fund the expansion.

____[3]

____

____

____

____

____

Self-Review of Unit 5: Finance

I have completed the following tasks (✓):

- ☐ Personalised Learning Checklist
- ☐ Glossary of key terms
- ☐ Read the exam 'top tips'
- ☐ Learnt the exam structures
- ☐ Read the topic information and completed all tasks
- ☐ Completed at least two revision clocks
- ☐ Answered **all** of the possible exam questions using the exam structures

The topics I understand well are.....

The topics I need to improve on are.....

My targets to help me improve in this unit are.....

1.

2.

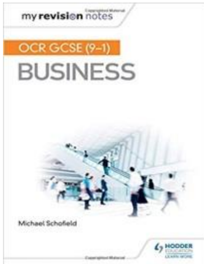
Additional Support

If you need any further support please speak to your teacher!

Course textbook: OCR GCSE (9-1) Business

https://www.amazon.co.uk/OCR-GCSE-9-1-Business-Third/dp/1471899365/ref=sr_1_2?crid=3CWFI3AR0SAZ9&keywords=ocr+gcse+business+studies+9-1&qid=1556985885&s=gateway&sprefix=ocr+gcse+business%2Caps%2C185&sr=8-2

Revision guide: My Revision Notes OCR GCSE (9-1)



https://www.amazon.co.uk/My-Revision-Notes-GCSE-Business/dp/1510423699/ref=sr_1_1?crid=3CWFI3AR0SAZ9&keywords=ocr+gcse+business+studies+9-1&qid=1556986123&s=gateway&sprefix=ocr+gcse+business%2Caps%2C185&sr=8-1

You could also try the following websites:

http://www.bbc.co.uk/education/subjects/zpsvr82

http://www.businessed.co.uk/index.php/home/activities/gcse-activities/gcse-activities-topic

https://www.tutor2u.net/