Finance Unit 6

AQA GCSE Business 9-1: 8132

AQA

Appears in: Paper 2

3.6.1 - Sources of finances

See over for the definitions of the following sources of finance.

Method	Benefits / Issues
Friends / Family	May not charge interest, or may let you repay over a more relaxed time-frame – but could harm relationships
Retained Profit	No interest and money is available instantly – but once it has been spent it is gone. Borrowing may be needed later.
Sale of Assets	Selling unwanted gods may result in the business getting back less than they paid.
Loan / Mortgage	Interest is charged on the loan – there is a rigid schedule for repayment. Reliable, interest rates are low.
Credit Card / Overdraft	Pre-arranged borrowing from a bank – can be spent like money – instant access – but typically high interest rates.
Sale and Leaseback	For items the business still needs, they can sell the building (e.g.) and then lease or rent it back from the new owner.
Trade Credit	Buy now-pay later. Enables business to obtain the resources they need, then are given x days to repay.
Hire Purchase	A deposit is paid, the business receives the goods and then is leant the remainder which they repay over time with interest.
Government Grants	Businesses can apply for grants that match things the government wants to encourage. i.e. small business start-up grants in areas of high unemployment.

Obtaining Finance:
Businesses use finance to pay for:
- Variable costs such as raw materials
- Overheads such as labour
- Land / Buildings / Capital Goods like machinery

It can be difficult to obtain finance, for this reason businesses create detailed business plans that can be used to convince lenders to give them **credit**.

Suitability of different methods:
Depending on the size, age and financial stability of a business, some methods may be more appropriate. **New businesses** might struggle to get loans from a bank, and so often owners will put their own money and money borrowed from family into the company. **Established businesses** who have a track record of making money and repaying debts will be more likely to borrow more.
Sometimes businesses only need to borrow **small amounts or for a short time**, meaning things like Credit cards, overdrafts, and Trade Credit become good choices.

Interest = cost of borrowing or the reward for saving

3.6.3 - Financial terms and calculations

Businesses all aim to make a profit (for charities and NGOs this profit is usually in the form of a positive outcome for their cause). As a result we have to pay close attention to finances.

Profit = income is greater than expenditure
Loss = expenditure is greater than income

To calculate a businesses profit/loss we have to understand the relationship between costs and revenue. (see over for definitions of the terms below).

$$Profit\ or\ Loss = Revenue\ - Total\ Costs$$

$$Total\ Costs = Fixed + Variable\ Costs$$

Calculating Total Costs can catch people out – often you're given a single figure for Fixed Costs, but a **cost per unit** for Variable Costs. This means you need to calculate:

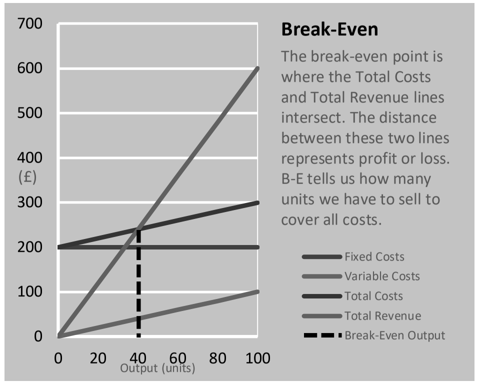
$$Total\ VCosts = Cost\ per\ unit\ \times the\ number\ of\ units$$

Margin of Safety
How many units are we making, above the break-even output. In the example, were the business making 60 units, the MoS would be 20 as the BEO is 40.

Average Rate of Return (ARR)
This is a method of investment appraisal. It looks at possible investment options and gives the % of the initial cost that will be returned as profit each year.

$$ARR\ (\%) = \frac{Average\ Profit\ per\ year}{Initial\ Cost}\ X\ 100$$

The investment option with the higher ARR % will most likely be chosen. However, other factors such as total profit, initial costs, and market conditions might also affect a company's choice.



3.6.2 - Cash flow

Cashflow is the term used to describe money entering and exiting a business. If cashflow is positive, then the business has the funds available to operate. If it is negative, they may not be able to pay their debts or be able to afford to buy stock etc.

Cash is king, and having enough cash available (either from sales or from borrowing) is vital. If a business has negative cashflow they will need to do something about it – possible solutions to cashflow problems include:
- **Re-scheduling payments** with creditors (people we owe money to) can allow extra time for more money to come in from sales

Thomas Cook went out of business in 2019, not because they didn't make profit – but because they didn't have sufficient cash to make their repayments on their debts. Their creditors refused to extend deadlines. Unable to find alternative sources of credit – they defaulted on their loans and were forced to declare bankruptcy.

- **Cutting costs** will reduce cash outflows and improve net cashflow as long as it doesn't harm our ability to generate sales
- **Increasing sales** will increase our inflows – but could cost us money (on marketing) in order to do it
- **New sources of finance** could make up the cash shortfall

Cashflow Forecast
Businesses need to predict whether they are likely to have any cashflow problems in the near future, as they may need to put finance in place to cover any deficit between income and expenditure.

In the example below, we can see that this business is predicting **positive net cashflow in January** – they will spend less than they earn. Whereas in February and March they expect **negative cashflow**, they will spend more than they earn. By the end of March they will have a negative bank balance. They will need some finance, possibly from their bank agreeing an Overdraft.

	January	February	March
Opening Balance	50,000	60,000	50,000
Cash in-flows	100,000	70,000	10,000
Cash out-flows	90,000	80,000	70,000
Net cash flow	10,000	(10,000)	(60,000)
Closing balance	60,000	50,000	(10,000)

3.6.4 - Analysing the financial performance of a business

Income Statement
This document shows the profit or loss of a business. (see over for descriptions)

Item	2018 (£m)	
Revenue	300	Money from Sales
Cost of Sales	100	Variable Costs
Gross Profit	**200**	300-100 = 200
Overheads	50	Fixed Costs
Operating Profit	**150**	200-50 = 150
Tax and interest	25	
Net Profit	**125**	150-25 = 120

Statement of Financial Position
This document shows the assets and liabilities of a business.

Assets are things the business owns
Liabilities are the debts of the business
Current means an asset or liability we will have for less than a year, **non-current/fixed** for more than a year.

Balance Sheet	£m	
Fixed Assets	**400**	Buildings etc.
Current Assets		These are things we will own for less than one year. **Debtors** is the money still owed to us by our customers. We own their debt, therefore this is an Asset.
Stock	174	
Debtors	109	
Bank and Cash	17	
Total Current Assets	**200**	
Current Liabilities	**(100)**	Payments we need to make this year
Net Current Assets	**100**	Current assets – current liabilities
Net Assets Employed	**500**	Fixed + Net Current Assets
Non Current Liabilities	**195**	Long-term debts
Net Assets	**305**	All assets – all liabilities
Equity / Reserves		This is the money that has been invested by shareholders (Capital) and the money we have reinvested from past years (Reserves)
Capital (Equity)	125	
Reserves	180	
Total Equity	**305**	

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Key Term	Definition
Asset	Something owned by a business.
Average rate of return	The average amount of profit made from an investment, as a percentage of the initial cost. $ARR\ (\%) = \frac{Average\ Profit\ per\ year}{Initial\ Cost}\ X\ 100$
Break-even Chart	A graph showing costs and revenue, and the point where they cross is the break-even point, this shows the output required to break-even.
Break-even Output	How many units must be sold in order to break-even. At this point, total costs and total revenue are the same.
Cash	Money that the business has in cash or in the bank available to spend.
Cash flow	The money moving into and out of the business.
Cash flow forecast	A prediction of how much money will flow into and out of the business. It is a planning tool.
Cash Inflow	Money coming into the business.
Cash Outflow	Money going out of the business.
Closing Balance	How much money still in the bank account at the end of a month / year.
External Sources of Finance	Getting money from business, people, or other organisations outside the business. For example, loans from banks, selling shares to private investors, subsidies from the Government.
Fixed Costs	Costs that do not change when our output changes. For example, rent.
Government Grants	Money given to businesses by the Government in exchange for them operating in a particular place or way. They must be applied for.
Gross Profit / GP Margin	$Gross\ Profit = Total\ Revenue - Costs\ of\ Sales$ $Gross\ Profit\ Margin\ (\%) = \frac{Gross\ Profit}{Revenue}\ X\ 100$
Hire Purchase	Buying items by making an initial payment, then paying the remaining money owed over a longer period of time.
Income Statement	A document that summarises the money moving into and out of the business. Showing whether a profit or loss is being made.
Interest Rates	The reward for saving, the cost of borrowing. A percentage added to the balance (of the savings or loan) for a given period of time – such as each month.

Key Term	Definition
Internal sources of finance	Funding the business using the owners' own money, by selling assets belonging to the business, or by making use of Sale & Leaseback.
Liability	The responsibility for debts of a business. If a business takes out a loan, it becomes a liability – the business is responsible for repaying.
Loans / Mortgages	An amount of money borrowed for a period of time, with an agreed rate of interest and deadline, repaid in instalments. Mortgages are a special type of loan, for more money paid back over a longer time in order to buy property.
Loss	Expenditure is greater than income.
Margin of Safety	How many more sales are being made than necessary to break-even.
Net Cash flow	The difference between cash inflows and outflows. $Net\ Cash\ flow\ =\ Cash\ Inflows - Cash\ Outflows$
Net Profit	$Net\ Profit = Operating\ Profit - Tax\ \&\ Finance\ costs$
Opening Balance	How much money is in the account at the beginning of a month or year.
Operating Profit / OP Margin	$Operating\ Profit = Gross\ Profit - Overheads$ $Operating\ Profit\ Margin\ (\%) = \frac{Operating\ Profit}{Revenue}\ X\ 100$
Overdraft	Agreed amount that can be spent when the balance of a bank account if £0, this allows the balance to be negative.
Profit	Income is greater than expenditure.
Profit Margin	What percentage of revenue is being kept by the business after different costs have been paid.
Profit Maximisation	Setting out to make the most profit possible, even if it means not achieving, or having to put on hold, other goals.
Raising Finance	Getting the money to invest in machinery etc. to start or grow a business.
Retained Profit	Profit from previous years that has been kept for future projects. This is an internal source of finance.
Revenue	Income from sales.
Sale & Leaseback	A business sells an asset and then leases it back from the new owners. An internal source of finance that allows a business to release money tied up in buildings or expensive equipment.
Share issue	The business is divided into more shares, the new shares are made available for the public to buy, and the business receives the money. An external source of finance.
Statement of Financial Position or Balance Sheet	Also called a Balance Sheet – a document that summarises the assets, liabilities, and equity of a business.
Total Costs	All costs a business must pay in order to operate.
Variable Costs	Costs that change depending on the level of production. For example, when more units are produced, more raw materials are consumed.

6 Mark Questions

Command words:
- **Analyse the impact** – a business will be considering, or will likely be affected by a business issue. You will need to, in detail, analyse how they are affected.

Important elements of the mark scheme:
- **No AO1** – there are no marks awarded for just demonstrating knowledge. Without analysis and application to the context you will score 0.
- **How many** – the question might tell you how many effects to analyse, if it doesn't say – the safest bet is to pick **one** and analyse with 5 steps.
- **Context** – you need to apply your knowledge to the specific situation described in the question. No application to the context = no marks!

State the impact

What does this lead to

What does this lead to

Are there other areas of the business that could be affected by this impact?

What does this lead to

Altogether, what could this result in?

9 Mark Questions

Command words:
- **Recommend** – you will be presented with options for a specific business in context. You will have to decide on which you believe is the best option and make a **definitive** recommendation.

Data:
- **Calculations** – it is likely that there will be some data presented with this question that doesn't mean you necessarily have to do any calculations, but look carefully at the data and the question, would it help your answer?

Important elements of the mark scheme:
- **No AO1** – there are no marks awarded for just demonstrating knowledge. Without analysis and application to the context you will score 0.
- **Sustained line of reasoning** – no flip-flops! You can't change your mind halfway through! you need to decide at the beginning on your choice.

- **Data** – if there is any data discussed in the question then you need to use it in order to get **any** marks.
- **Evidence** – where you get credit for your knowledge is by using it as evidence to support your recommendation.
- **Conclusion** – finish your answer with a conclusion that is supported by your evidence.

State your recommendation

Explain your reasons for choosing this option

Add any relevant data from the question and case study (if there is any)

How could this choice affect other areas of the business?

Are there 'potential issues' with this option the business need to know?

(Briefly) What will they miss out on by choosing this option?

Conclusion – overall they should choose your option because? What's the most important reason?

12 Mark Questions

Command words:
- **Analyse which will have the <u>greater</u> impact** – you will be presented with two business issues that could be unrelated. You will need to consider which one will have a greater impact on the context presented in the question.

Data:
- **Calculations unlikely** – in these questions they are testing your analysis and evaluation. There may be data from the case study or past questions within the same section that might be useful as part of your analysis though.

Important elements of the mark scheme:
- **No AO1** – there are no marks awarded for just demonstrating knowledge. Without analysis and application to the context you will score 0.
- **Integrated line of reasoning** – not just no flip-flops, this time you need to have a common theme that runs through your answer. Practice these questions and when you look at your answer afterwards, does it seem like multiple separate parts? If so, it's not **integrated**.
- **Interdependent nature of business** – all areas of a business are reliant upon all other areas – from your analysis it should be obvious that you're considering the wider implications of both options.
- **Conclusion** – another opportunity to show the interdependent nature of business, in your conclusion try to draw together the two topics. Then finish confidently explaining why the one you chose has a greater impact than the other.

State which topic will have the greatest impact. Doing this at the beginning is a way of ensuring you have written it before running out of time!

Discuss this topic – how will it affect the business? Analyse this point in detail.

How could this topic affect other areas of the business? You need to discuss more than one functional area of the business.

How might the **other topic** affect this business?

How does this affect the broader business **less** than your chosen topic?

Conclusion – overall how might either topic affect the business? Are there any ways in which they would both affect the business the same way?
Now, your topic – the big finish **– why will your topic affect the business more than the other one?**