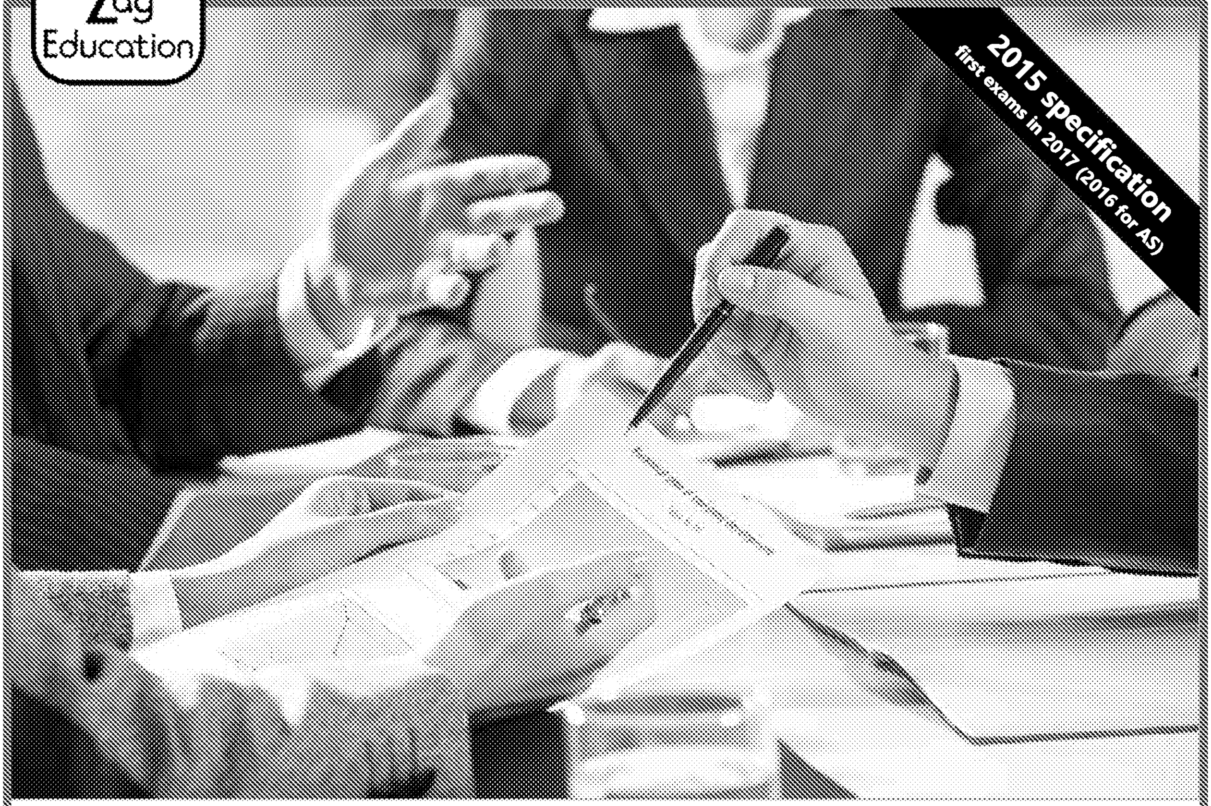


Theme 2: Managing Business Activities

Course Companion for AS and A Level Edexcel Business

zigzageducation.co.uk

POD 5854

Contents

Teacher's Introduction

This resource has been written to support the learning and teaching of Edexcel Level 3 Advanced GCE in Business (Theme 2: Managing Business Activities). It gives an in-depth view of the new qualification, presenting what specification points students need to know, plus extras along the way for extended learning.

At the beginning of each chapter, you will find a list of contents showing every specification point that is covered. There are also questions and answers at the end of each chapter that help students transfer their knowledge into real-world business contexts. Any key terms are explained chapter by chapter and are also revisited as a glossary at the end of the resource.

Students get plenty of chance to practise their quantitative skills in this resource, including:

- **QS 1:** calculate, use and understand ratios, averages and fractions (chapters 2.2.2., 2.3.1. and 2.3.2.)
- **QS 2:** calculate, use and understand percentages and percentage changes (chapters 2.2.4., 2.3.1. and 2.4.2.)
- **QS 3:** construct and interpret a range of standard graphical forms (chapters 2.1.4., 2.2.2. and 2.2.3.)
- **QS 4:** interpret index numbers (chapter 2.5.1.)
- **QS 5:** calculate cost, revenue, profit and break-even (chapters 2.2.2. and 2.2.3.)
- **QS 8:** use and interpret quantitative and non-quantitative information in order to make decisions (all chapters)
- **QS 9:** interpret, apply and analyse information in written, graphical and numerical forms (all chapters)

While extremely valuable to a student's revision, this resource should be treated as a companion to the many other textbooks and activity guides available. As with any subject, it is good to read as widely as possible!

The subjects covered in this resource include everything from methods of finance and sales forecasting to budgets, break-even and capacity utilisation. The notes included in this resource can be given to students before a lesson as preparation for a topic, afterwards in order to help solidify their knowledge, or can be used by teachers as a supplement to in-class exercises and activities.

It is hoped that this resource, as well as offering support for teaching the essential elements of the Edexcel examination, will help students build on their research and dissemination skills. The business world is a constantly changing one full of fascinating stories. This resource attempts to share some of these stories as a basis for teaching in the most interesting way possible, meanwhile encouraging further study from the next generation of business analysts!

Happy teaching!

2.1. Raising Finance

Entrepreneurs raise finance for many reasons, including funding the set-up of a bu
developing production areas and expanding their current business.

The two main sources of finance available to businesses are generally internal and
finances raised from within the business, such as selling company assets, while ext
from outside the company, such as issuing shares to the public.

2.1.1. Internal Finance

! Key Points Covered

- Personal Savings
- Retained Profit
- Sale of Assets

Personal Savings

This finance, also known as the owner's capital, is the amount of cash that the bus
Personal savings are generally used by sole traders, partnerships and fresh start-u
assets.

✓ ***Advantages of using personal savings include:***

- The cash is quick to access since it is the business owner who is making the investment, rather than an external source, such as a loan provider
- If an owner is personally invested, he/she may take greater care in the success of the business

✗ ***Disadvantages of using personal savings include:***

- Any loss of profits for the business is a serious loss for the owner, who has invested so much
- Owners can be over-controlling of a business if they are also the inve

Retained Profit

This is the profit that a business keeps after all expenses, taxes and shareholder di
source of finance is available to most organisation types except fresh start-ups; th
made enough (or any) profit.

✓ ***Advantages of retained profit include:***

- If a business were to apply for a bank loan, they would need to provi
activities. Since the business already owned the retained profits, no c
confidential information
- Investment of retained profits can lead to development of a business
valuable than before. This would help increase the value of the busin
investors, and potentially attracting further investment.

✗ ***Disadvantages of retained profit include:***

- If a business makes a considerable amount in retained profits, shareh
they are not receiving higher dividends. This can lead to de-investme
and a potentially negative image for the business.
- There is an opportunity cost to be considered: a business might be d
retained profits or saving them in order to generate a healthy amoun
to invest their retained profits, they must be sure that they are going
developing their business than the interest they could have made by

Sale of Assets

This involves a business selling off their possessions, such as property or vehicles, in order to generate finance. This source is available to most business types, except new start-ups since they generally will not have any assets that they can afford to sell.

✓ *Advantages of sales of assets include:*

- It allows businesses to focus their funds on developing themselves, rather than keeping money locked up in assets
- Unlike a bank loan, for example, the finance is freely available to the business; all they need to do is sell the asset

✗ *Disadvantages of sales of assets include:*

- An asset is no longer an asset once it is sold; if a business still needs access to a factory, for example, but has already sold its asset, it will ne… Essentially, this turns a business's asset into a cost.
- The business needs to be sure that the asset is worth less to it than th… the now-available cash. This is a risk for any business.

2.1.1. Questions

Please write your answers on a separate piece of paper or in an exercise book.

1. *Identify and explain one advantage and one disadvantage for businesses using … finance:*
   a. *Personal savings*
   b. *Sale of assets*
   c. *Retained profit*

2. *Mariah Cherry is the owner of a small greengrocer business. Cherry currently ha… purchase another in order to grow her business. She has three choices for how t… new location: personal savings, retained profits or sale of assets.*

   Identify and explain which of the three methods of finances would be best for M…

2.1.2. External Finance

! Key Points Covered

- Sources of Finance
- Methods of Finan

While *sources* of finance include the people and organisations that offer funding t
is the way in which the finance is delivered to the business (and often how the bu

Sources of Finance

Family and Friends

For most businesses, costs are generally low at the beginning (especially compare
starts making profit), that is unless significant infrastructure is required, such as te
The costs may be relatively low but they are still high for businesses that are just s
development phase. As such, many new firms look to family and friends for financ

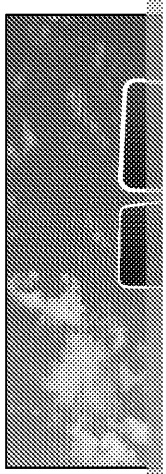
✓ *Advantages of family and friends as a financial source include:*

- Business owner and friend / family member can negotiate a payback
- Securing the finance is a relatively quick process since both the busin member already know each other

✗ *Disadvantages of family and friends as a financial source include:*

- Family/friends have a share in the business's profits. In the beginning, need another £10,000 in order to start trading. If a friend then puts u could represent half the business. In five years' time, the business cou and the friend who originally put up £10,000 would own half of that.
- Family/friends have a say in business activities. By investing financially substantial share in the business and, therefore, be able to influence h

Banks



All businesses have to answer to the bank manager in some way or another, whether asking for a loan, dipping into their overdraft or simply finding out the best way to save money. Most businesses can utilise the bank as a source of finance, though it can be difficult for less profitable (or still developing) firms to find support in this manner.

✓ *Advantages of banks as a financial source include:*

- Since banks are institutions, rather than individuals, there is potential for a business to access a lot of money
- The bank will not be a shareholder in the business and so the owner is free to use the money as they please

✗ *Disadvantages of banks as a financial source include:*

- Banks often require strict payback plans for borrowers
- Interest rates can increase, generating more costs for the business

Peer-to-peer Funding

This source of finance, also known as *peer-to-peer lending*, can involve any numbe
a million! Businesses request peer-to-peer funding by making formal applications
much money the business needs and what they intend to do with it. Each proposa
potential investors can see it. Investors are then welcome to put down as much, o
(there is normally a minimum investment amount). Once the proposal gets enoug
business receives 100 per cent of the requested finance.

Peer-to-peer funding is generally a source of finance chosen by start-ups and dev
firms may also use it as a way to generate finance for business development.

✓ ***Advantages of peer-to-peer funding as a financial source include:***

- There are few financial costs involved for the business, because peer-t organised online
- Peer-to-peer funding acts as a forum for business proposals: if the fu a problem with the proposal

✗ ***Disadvantages of peer-to-peer funding as a financial source include:***

- Peer-to-peer funding is a time-dependent process. This means that if confirmed investment to cover 100 per cent of the proposal by the ti
- While it does not cost the business financially, it takes a lot of time ar peer funding proposal

Business Angels

These investors offer their money, and services, to businesses often in exchange f
Business angels generally concentrate on bets that are 'unsafe'; such businesses a
anywhere else and so the business angel can demand a more favourable share in

✓ ***Advantages of business angels as a financial source include:***

- When a business has exhausted all other possibilities, a business ang
- Business angels also offer management advice, which can be vital to

✗ ***Disadvantages of business angels as a financial source include:***

- Since business angels prey on businesses that seem unsafe to other i negotiate a deal that benefits themselves but not the business
- Business angels can ask for a significant share in any business they h between management

Crowd Funding

This source works in a similar way to peer-to-peer funding with the main differen
funding is a loan, crowd funding offers a grant. Crowd funding of a business is als
individuals who are already interested in the business. If the business is a music ba
financiers will be fans. Like peer-to-peer, if a business requests crowd funding, the
the finance within a specified time limit, they receive nothing. With crowd fundi
something in exchange for a bid, such as a copy of the new record once its record
date with an author who needs funding for her next book.

✓ ***Advantages of crowd funding as a financial source include:***

- There are few financial costs involved for the business, because crowd
- Crowd funding acts as a forum for business proposals: if the funding problem with the proposal

✗ ***Disadvantages of crowd funding as a financial source include:***

- Crowd funding is a time-dependent process. This means that if the bu investment to cover 100 per cent of the proposal by the time limit, all
- While it does not cost the business financially, it takes a lot of time ar funding proposal

Other Businesses

It is common for big businesses to buy shares in smaller businesses, especially if they operate in the same market. Smaller firms are valuable, as they often control particular pockets of the market that bigger businesses find difficulty in penetrating (such as the environmentally conscious consumer). Smaller businesses also benefit from the finance that larger corporations can provide.

✔ ***Advantages of other businesses as a financial source include:***

- Bigger businesses have more funding available to support development of small firms
- If a business buys significant shares in a smaller firm, they can grant access to marketing power and commercial contacts, which would he

✘ ***Disadvantages of other businesses as a financial source include:***

- If investors own a large [illegible] the business, they will have significan which could [illegible] within the organisation
- [illegible] make their mark by targeting consumers who are in [illegible] (and often ethical) business. The small firms must be car [illegible] processes due to investor influence: small firms that start behavi (i.e. other bigger businesses) can lose the customer base that they ori

Methods of Finance

Overdrafts

Banks offer overdrafts to most of their customers, including businesses. Businesse the short term as a way to cover themselves during difficult months or while waiti

✔ ***Advantages of overdrafts as a method of finance include:***

- They are flexible; businesses can use them when they need to and pay money
- Businesses do not need to propose anything with their bank before u wish to extend their overdraft)

✘ ***Disadvantages of overdrafts as a method of finance include:***

- Interest rates are very high with overdrafts
- The amount of money covered by overdrafts is often very limited

Loans

Loans, provided by banks and other financial establishments, differ from overdraft business can use an overdraft as and when they need it (provided they haven't alr be planned for. A business makes a case to the loan provider (i.e. bank) in order to loan; the business and loan provider will then negotiate a loan amount and payme Businesses generally apply for loans as a way to pay for [illegible] expenses, such as ne

✔ ***Advantages of loans as a method of finance:***

- The payback is [illegible] between the business and loan provider
- Interest [illegible] generally lower than that of overdrafts

✘ ***Disadvantages of loans as a method of finance:***

- Businesses must normally provide a security deposit for loans, such as
- Since each loan is specific to the business, the loan provider will gene that the business has in assets

Share Capital

If two entrepreneurs start a business together, each person will own a 50 per cent share (unless they negotiate otherwise). A share, therefore, represents a stake in the business.

The status of shares can change over time. If a business becomes successful, it may become a private or public limited company. This would then allow other investors to stake a claim by purchasing shares. Businesses generally consider issuing share capital as a long-term form of finance: a firm would not consider this as a way to generate cash for a new piece of machinery.

✔ ***Advantages of share capital as a method of finance include:***

- Companies only pay shareholders ... they have been profitable
- Investors have limited ... their shares: this means that they do ... more than their ... if the business makes a loss

✘ ***Disadvantages of share capital as a method of finance include:***

- ... investors are buying shares in a business, they gain an element ... of interest.
- Shareholders expect dividends if a company is profitable, which mean... development of the firm

Venture Capital

This method of finance starts with a proposal; a business puts forward a plan to an investor, such as a business angel, to explain what the business wishes to do and how much money it needs. If the investor likes the plan, they will decide to invest by either granting the money or giving a loan.

A great example of venture capital success is Levi Roots' *Reggae Reggae Sauce*, which began as a single-kitchen operation in Brixton, London. Watch Levi's pitch on the BBC television show Dragon's Den:
http://www.bbc.co.uk/dragonsden/entrepreneurs/leviroots.shtml
(video link)

✔ ***Advantages of venture capital as a method of finance include:***

- Many venture capitalists are also successful business leaders and so ... businesses
- Venture capitalists aim for big rewards by taking risks and so they are ... even when all other investors say no.

✘ ***Disadvantages of venture capital as a method of finance include:***

- By investing in the company, the venture capitalist is taking a risk and ... company in return. This ... to a high demand of dividend paym... been reinvested ... the company.
- Advice ... to businesses, but investors can become too inv... ... of interest

Leasing
Many businesses choose leasing over purchasing items, such as property or equip more cash at the end. This option is also appealing when a business has a short-te not have the right equipment or the money to purchase it.

✓ ***Advantages of leasing as a method of finance include:***

- Businesses that lease do not have large amounts of money wrapped u cash left over for other things, such as business development
- The owner of the property is responsible for its maintenance rather th

✗ ***Disadvantages of leasing as a method of finance include:***

- Paying a lease on property is a continual cost to business, which woul the property, however (e.g. through taking out a mortgage), the busin at the end, which may be worth more than the money they could hav
- If the owner of the leased item decides to sell it, the business has no c

Trade Credit
When businesses make purchases from suppliers, they often negotiate a payback business to pay back in eight weeks, for example, the business is not going to pay cash can be used to finance other business areas instead while they generate mor

✓ ***Advantages of trade credit as a method of finance include:***

- Every supplier works in their own way and so the business can negoti suppliers to make certain they always have enough cash available to p
- Paying in eight weeks instead of one ensures the business has cash av and development

✗ ***Disadvantages of trade credit as a method of finance include:***

- The business must be sure they are going to have the cash available b may issue a significant charge to the business as a penalty.
- In addition to the previous point, the business may suffer the consequ badly about them, which could lead to fewer suppliers wanting to neg

Grants
These are provided by many different entities, including government bodies, finan businesses who wish to support the next crop of young entrepreneurs. In order to submit a proposal to the grant provider, which shows what they plan to do with th the business receives the money and does not have to pay it back.

✓ ***Advantages of grants as a method of finance include:***

- The funding does not cost the business anything as there is no payba
- The grant provider is not looking for a stake in, or any control of, the b

✗ ***Disadvantages of grants as a method of finance include:***

- There is often a stipulation with grants, such as a local council offering pledge to move their production line to that particular area
- With the stipulation, if a business does not meet all the criteria requ be under 25 or business must already have made £100,000 in pr funding offered

Royal Trust Grants a Princely Sum
The Prince's Trust was set up by Charles, Prince of Wales as a charity to support yo 18 to 30) in gaining employment, education and/or starting their own businesses. created 125,000 entrepreneurs.

2.1.2. Questions

Please write your answers on a separate piece of paper or in an exercise book.

3. *Put the following methods of finance in the correct category. The first one has b*

Overdraft   Loan   Personal savings   Venture capita

Share capital   Retained profit   Grant

Internal Finance	Ext
	Overdraft

4. *Explain the difference between a* source of finance *and a* method of finance.

2.1.3. Liability

Key Points Covered

- Unlimited Liability
- Limited Liability

A business owner that has *unlimited liability* has complete responsibility for the fi with *limited liability*, on the other hand, has a set financial point that they are resp

Unlimited Liability

Smaller businesses, such as sole traders and partnershi e xamples of unlimit the person who started the business and is respor ibl r all assets and finance. I liability gets into financial trouble, i.e. th ab utweigh the assets available, the Unlimited liability means it is th esp ility of the owner to cover every penny liability, therefore, is un .

Limited ity

This type of liability is concerned with larger firms, such as private limited compan Each shareholder of a company is a partial owner of the entire business. This own 0.1 per cent to 100 per cent of the business. Each shareholder has limited liability this means that shareholders are only responsible for the shares they have not yet

Example:

Mad Hatters plc started life as a retailer of hats and scarves. Once it became succe the company was floated on the stock market with 250 shares going for £10.00 ap Five investors bought up to 50 shares each, but only managed to pay off 20 of the Each investor, therefore, owned 50 shares but still owed the money for 30.

After the stock market floatation, Mad Hatters plc's shareholders encouraged the company to sell novelty sun hats in cold climates. This did not go well and eventu led to the closure of the business. Mad Hatters plc went into *liquidation*, which me they had to sell off all their assets in order to pay the debts.

However, the assets were not enough to pay off the debts – that's why the business to close. So who was responsible for the company's finances?

The responsibility for Mad Hatters plc fell with the company's shareholders, who a had limited liability. This means that each shareholder only owed back on the shar they had not yet paid for. In this case, each shareholder owed 30 shares at £10.00 each, i.e. £300.00.

The Mad Hatters plc example demon es it is relatively easy for businesses issue. Investors have limited li y, i mited to the value of the shares they ow to put money down s y ow this is also the maximum they can stand to lo

Note the di ce: When businesses with unlimited liability are forced to close, same thing happens to companies with limited liability, however, they go into *liqu*

2.1.3. Questions

Please write your answers on a separate piece of paper or in an exercise book.

5. *Copy and fill in the following table.*

Characteristic of a Business	Limited Liabi [TRUE/FALS
If a business gets into financial trouble, it may go bankrupt.	
Total financial responsibility for a business falls with its owners, who are generally also the founders.	
If a business gets into financial trouble, it may go into liquidation.	
Business owners are financially responsible only for how much investment they put in.	

6. *Identify and explain one reason why it is generally easier to raise cash as a comp company with unlimited liability.*

2.1.4. Planning

! Key Points Covered

- Relevance of a Business Plan in Obtaining Finance
- Cash-flow Forecasts
- The Use and Limitations of Cash-flow Forecasts

Quantitative Skills Co
QS 3: construct and in
graphical forms

Relevance of a Business Plan in Obtaining Finance

Imagine that you are an entrepreneur about to propose your business idea to a p need? A plan!

No investor is going to look twice at your business idea if you do not have a solid business angels, friends, family or any kind of financial provider. You need to prov financial support and that it does not represent significant risk to the finance prov business idea that is low risk allows you, the business owner, to negotiate better reasonable [illegible]k process.

What Goes into a Business Plan?

Without a proper plan, an entrepreneur does not really have a business to discuss breakdown of what you intend to do as a business and how.

Some of the questions that business plans should answer include:

- What problems does this business idea solve?
- How does it solve the problems? Why is it solving the problems?
- How will the business make its money?
- How much money will the business make in its first year, second year, etc.?
- What is the market for this product/service?
- Who is the competition?
- How will your business compete with these? Differentiation? Unique sellin
- How long will it take to build the business? What equipment/premises are
- What profits/losses can you expect by the end of year one, year two, etc.?

Check out the BBC TV show *Dragon's Den* for some great (and not so great) exam **http://www.bbc.co.uk/programmes/b006vq92** (video link)

Cash-flow Forecasts

One plan that businesses often use, both when proposing their ideas to investors six months to a year, is the cash-flow forecast. This shows how much cash will be over a specific period of time. It is a prediction based on data that the business h

Sunny Side Up Ltd is a company that manufactures deck chairs and garden furnitu flow forecast for the company during the year.

All figures in £000	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Au
OPENING BALANCE	50	(10)	(70)	(30)	0	20	70	11
INFLOW								
Sales	20	20	120	110	150	130	130	11
TOTAL INFLOW	70	10	50	80	150	150	200	22
OUTFLOW								
Equipment hire	0	0	0	0	0	0	10	0
Wages	70	70	70	70	70	70	70	70
Factory maintenance	0	0	0	0	50	0	0	0
Marketing and advertising	5	5	5		5	5	5	5
Other expenses	5	5	[illegible]	5	5	5	5	5
TOTAL OUTFLOW	[illegible]	80	80	80	130	80	90	80
CLOSING BALANCE	(10)	(70)	(30)	0	20	70	110	14

Note: the closing balance of each month is calculated by subtracting TOTAL OUTFLOW from TOTAL INFLOW. This figure, the closing balance, is carried forward as the opening balance for the next month.

Note: negative figures on cash-flow forecasts are shown using brackets (parentheses)

The forecast shows Sunny Side Up Ltd will have a negative cash flow by Decembe in the spring and summer months while autumn and winter months are more diff

Your turn:
Fill in the following cash-flow forecast for Sunny Side Up Ltd. The opening balanc

All figures in £000	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Au
OPENING BALANCE	150							
INFLOW								
Sales	20	20	120	110	150	130	130	11
TOTAL INFLOW								
OUTFLOW								
Equipment hire	0	0	0	0	0	0	10	0
Wages	70	70	70	70	70	70	70	70
Factory maintenance	[illegible]	0	0	0	50	0	0	0
Marketing and advertising	5	5	5	5	5	5	5	5
Other expenses	5	5	5	5	5	5	5	5
TOTAL OUTFLOW	80	80	80	80	130	80	90	80
CLOSING BALANCE								

The Use and Limitations of a Cash-flow Forecast

Cash-flow forecasts are useful for businesses because they show when there will be cash available to pay expenses. They also show when cash will be tight and, therefore, when the company needs to be more careful. Cash-flow forecasts are good for use in negotiations over finance, such as trade credit, because the business can demonstrate exactly when they expect to have the cash available to pay their suppliers.

There are limitations with cash-flow forecasts, however, which include:

- Forecasts are based on predictions that were accurate at the time; however, things change (such as consumer tastes in garden furniture)
- Forecasts are less accurate over long periods of time
- Unforeseen expenses may hit the business, coming from external factors
- Forecasts are only predictions and businesses should not depend on them alone
- Technology can change, which makes production cheaper / more expensive
- Competitors and how they may change the market are not accounted for
- Seasonal activity, such as buying garden furniture in summer, may change

2.1.4. Questions

Please write your answers on a separate piece of paper or in an exercise book.

7. *Complete the following cash-flow forecast.*

All figures in £000	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.
OPENING BALANCE	125							
INFLOW								
Sales	100	75	70	70	50	50	45	40
TOTAL INFLOW								
OUTFLOW								
Equipment hire	20	0	0	0	0	0	0	0
Wages	90	90	90	90	90	90	90	90
Factory maintenance	0	0	75	0	0	0	0	0
Marketing and advertising	10	0	0	0	0	0	0	0
Other expenses	15	15	15	15	15	15	15	25
TOTAL OUTFLOW								
CLOSING BALANCE								

8. *Identify and explain one benefit and two limitations of using a cash-flow forecast.*
   Benefit:
   Limitation one:
   Limitation two:

Focus: Innocent Drinks

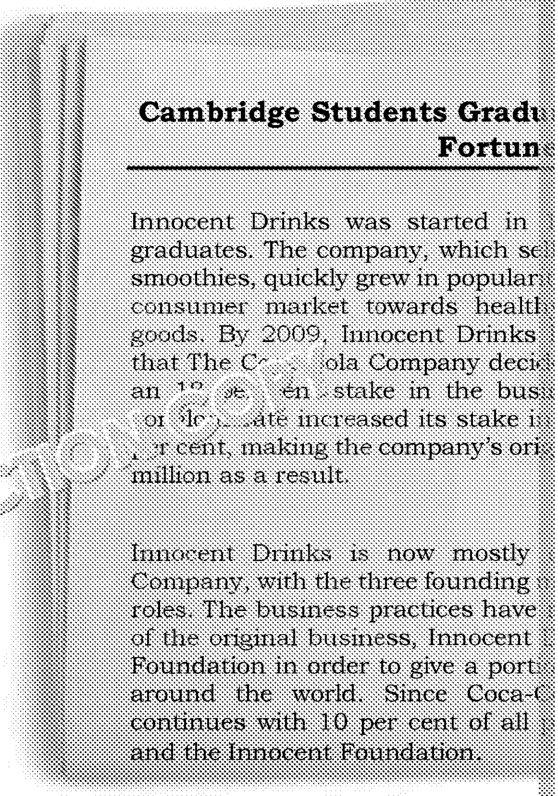
Questions:

a) Identify and explain two reasons why a company chooses to issue share capital.

b) Explain two ways in which Innocent Drinks' success could have been affected by the buyout from The Coca-Cola Company.

c) Compare the benefits and drawbacks of a business having unlimited liability with having limited liability.

d) Analyse why The Coca-Cola Company decided not to make many changes to the business practices of Innocent Drinks.



Cambridge Students Gradu
Fortun

Innocent Drinks was started in
graduates. The company, which se
smoothies, quickly grew in popular
consumer market towards healt
goods. By 2009, Innocent Drinks
that The Coca-Cola Company deci
an 1? per cent stake in the bus
... increased its stake i
per cent, making the company's ori
million as a result.

Innocent Drinks is now mostly
Company, with the three founding
roles. The business practices have
of the original business, Innocent
Foundation in order to give a port
around the world. Since Coca-C
continues with 10 per cent of all
and the Innocent Foundation.

Source: http://www.theguardian.com/business/201

2.1. Keywords

Dividend:	The share of the profits that shareholders receive
Shareholder:	A partial owner of a company. Shareholders inves for a stake in its success.
Grant:	Cash that is given to a business. Unlike with loans grants back.
Share:	Partial ownership of a company. If, for example, a and one person owns 10 shares, they own 10 per
Stock market:	A place where company shares are bought and so York and London stock exchanges.
Float:	When a company decides to trade its shares on th
Liquidation:	A company's assets are no longer enough to pay close. The company will then sell off its assets in o

2.1. Answers

1. **Identify and explain one advantage and one disadvantage for busin methods of finance:**
   a. **Personal savings**
   Advantages:
   There are no payback terms for the owner to sign.
   The owner may take closer care of their company because they are so

   Disadvantages:
   Business owner may invest too much of their own time into the firm b
   If the firm loses money, the owner is greatly affected.

   b. **Sale of assets**
   Advantages:
   Assets are relatively easy to convert into cash.
   Any assets that the company owns are potentially holding money that c

   Disadvantages:
   Machinery is an integral asset. Once sold, however, it can no longer be
   If a firm needs its asset back, it will either have to purchase or rent. Bo

   c. **Retained profit**
   Advantages:
   No confidential business information required in order to access the f
   The business can appear more valuable to potential investors as a res

   Disadvantages:
   Too much reinvestment of retained profits can cause dissent in shareh
   Opportunity cost of whether the investment is worth it, i.e. what is the potential payoff?

2. **Mariah Cherry is the owner of a small greengrocer business. Cherry is looking to purchase another in order to grow her business. She h fund the purchase of the new location: personal savings, retained p Identify and explain which of the three methods of finances would b business expansion.**
   Students are expected to choose retained profits in this instance. Reasons f
   - *Retained profits can be accessed with very little effort on the busin*
   - *Investment can make the business look more attractive to other po help further growth*
   - *This is better than personal savings. If Mariah Cherry used her ow new location, she would be completely liable if the venture failed.*
   - *This is also better than sale of assets. Mariah Cherry's business is st not have enough assets of worth to sell, besides the original locatio place she generates sales*
   - ***One note on retained profits, however:** the business must be car investment and be sure that it will pay off*

3. **Put the following methods of finance in the correct category. The fir**

Overdraft	Loan	Personal savings	Ven
Share issue	Retained profit		Gran

Internal Finance	Ext
Personal savings *Retained profit* *Sale of assets*	*Overdraft* *Loan* *Share issue* *Venture capital* *Grant* *Trade credit*

4. **Explain the difference between a *source of finance* and a *method of f***
Source is the person/group wh... the finance (e.g. bank), wherea... the finance is delivered ...).

5. **Copy ... the following table.**

Characteristic of a Business	Lim Liab [TRUE
If a business gets into financial trouble, it may go bankrupt.	FA
Total financial responsibility for a business falls with its owners, who are generally also the founders.	FA
If a business gets into financial trouble, it may go into liquidation.	TR
Business owners are financially responsible only for how much investment they put in.	TR

6. **Identify and explain one reason why it is generally easier to raise ca liability than as a company with unlimited liability.**
Students must show understanding that a company with limited liability is raise capital, which companies with unlimited liability (such as sole trader

7. **Complete the following cash-flow forecast.**

All figures in £000	**Jan.**	**Feb.**	**Mar.**	**Apr.**	**May**	**Jun.**	**Jul.**	**Aug.**
OPENING BALANCE	*125*	*90*	*60*	*(50)*	*(85)*	*(140)*	*(195)*	*(255)*
INFLOW								
Sales	*100*	*75*	*70*	*70*	*50*	*50*	*45*	*40*
TOTAL INFLOW	*225*	*165*	*130*	*20*	*(35)*	*(90)*	*(150)*	*(215)*
OUTFLOW								
Equipment hire	*20*	*0*	*0*	*0*	[illegible]	*0*	*0*	*0*
Wages	*90*	*90*	[illegible]	*90*	*90*	*90*	*90*	*90*
Factory maintenance	[illegible]	*0*	*75*	*0*	*0*	*0*	*0*	*0*
Marketing and advertising	*10*	*0*	*0*	*0*	*0*	*0*	*0*	*0*
Other expenses	*15*	*15*	*15*	*15*	*15*	*15*	*15*	*25*
TOTAL OUTFLOW	*135*	*105*	*180*	*105*	*105*	*105*	*105*	*115*
CLOSING BALANCE	*90*	*60*	*(50)*	*(85)*	*(140)*	*(195)*	*(255)*	*(330)*

8. **Identify and explain one benefit and two limitations of using a cash**

Example benefits:

- *Timings. Firms use data to predict when cash comes in and goes out. T understand when they will have a positive cash flow and when a nega of when they can afford to pay suppliers and bills.*
- *Guidelines. Some businesses use forecasts in order to mark out sales t*

Example limitations:

- *Cash flow forecasts do not work well as long-term predictions as firms bills that are going to come their way. They are only predictions!*
- *Technology can change, making the production process cheaper / mo change all the time, affecting the demand for the company's products,*

2.2. Financial Planning

2.2.1. Sales Forecasting

! Key Points Covered

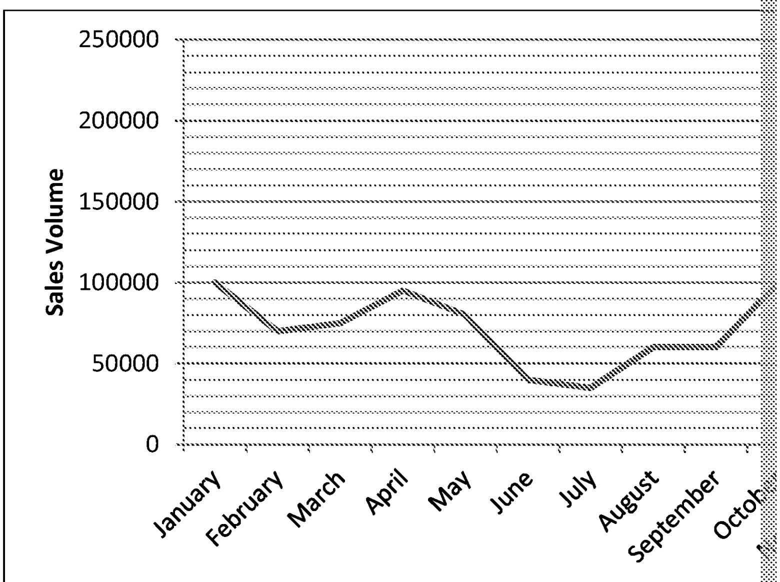
- The Purpose of Sales Forecasting
- Factors Affecting Sales Forecasts
- Difficulties of Us

In order for a business to create an effective cash-flow forecast (see section 2.1.4.) what sales they can expect.

The Purpose of Sales Forecasting

Businesses draw up sales forecasts in order to make better decisions, such as whe recruit staff or hire e... ises.

Racing Stripes plc is a car-painting service based in the UK. The company, which fi drawn up a forecast of the number of sales they expect to make during 2016.



Graph: Sales forecast for Racing Stripes plc during 2016

The forecast shows that Racing Stripes plc expects the majority of its sales to com The company may need to plan for this spike in sales; they could do this by adver November and December or renting out more equipment for those months in ord

This theory goes for low points in sales; Racing Stripes plc expects July to be and so it does not make sense to hire extra staff during that period.

Factors Affecting Sales Forecasts

Consumer Trends

Just because something is popular one year does not mean it will still be that way their minds often and companies should be aware of any market trends that coul

Changes in consumer trends can come for all sorts of reasons, such as:

- Advanced technology creating demand for different products/services
- Environmental or ethical issues growing in importance
- Fashion changes
- Celebrity endorsement

Economic variables

Companies should be aware of any economic variables that will affect their marke
when forecasting sales. In times of economic decline, for example, average consu
than they would have during economic growth.

Competition

Companies need to stay up to date on their rivals and what they are bringing to t

Example:
If a mobile phone company introduces a product that is an instant hit, the rest of
probably suffer by making fewer sales. The other companies will then either have
decisions (such as introduce their own version of the same product) or will have t
reflect the change.

External factors

For many businesses, there are factors far beyond their control. If a business impo
country, for example, which is suddenly torn apart by war, the company will suffer r
produce th[illegible]s. The same countries could also be affected by natural disaster
significantly [illegible] winter, and the companies involved would suffer in reduced sal

Your turn:
Identify which factors could affect the sales forecast of Racing Stripes plc. Explain
response:

- Should it change its sales forecast?
- Would it be better for Racing Stripes plc to make different business deci

The Difficulties of Using Sales Forecasts

Much like cash-flow forecasts, sales forecasts are limited in their usefulness:

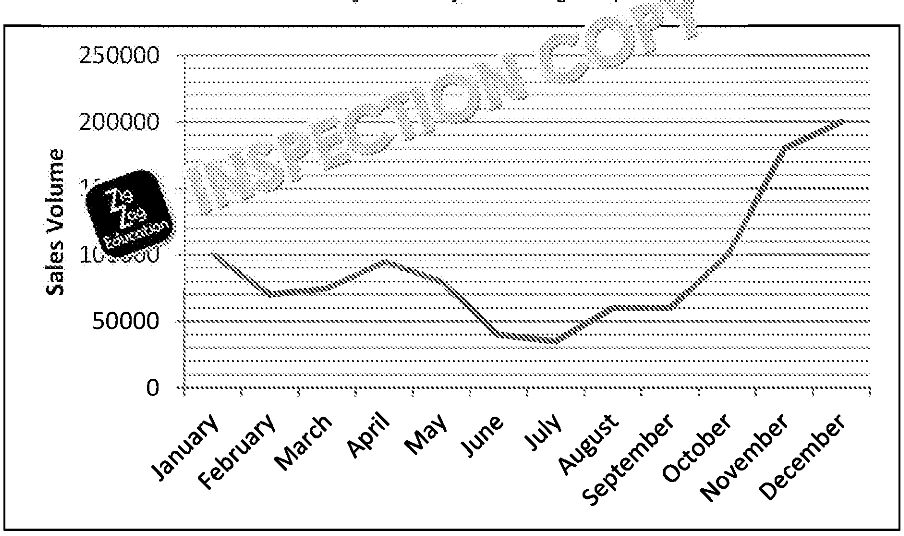
- Forecasts are less accurate over long periods of time
- They are only predictions and so businesses should not depend on them
- Any factors that can affect a business's sales, such as economic decline, c
  are not accounted for in a forecast
- Forecasts are correct to the best of a business's own knowledge, but they
  market as a whole – it is a one-sided presentation

2.2.1. Questions

Please write your answers on a separate piece of paper or in an exercise book.

1. *Identify and explain three factors that can cause sales forecasts to increase or d*

2. *Take another look at the sales forecast for Racing Stripes pl*



2.2.2. Sales, Revenue and Costs

! ***Key Points Covered***

- Calculation of Sales Volume and Sales Revenue
- Calculation of Fixed Costs and Variable Costs

Quantitative Skills Cov
QS 1: calculate, use and
QS 3: construct and inte
graphical forms
QS 5: calculate cost, rev

The calculations for sales volume and revenue show a bus how many sales th how much cash flow this represents.

Calculation of Sales Volume and Sales Revenue

Sales Volume

This is the n o s that a company has made. In order to calculate sales v

- *Pric nit*, i.e. the price of one single product/service
- *Total sales revenue*

The calculation is then:

$$Sales\ Volume\ = \frac{\text{Total Sales Revenue}}{\text{Selling Price Per Unit}}$$

Example:

Alarms 4 U Ltd sell £50,000 of car alarms in one year. The selling price of each car

The calculation for this is:

$$Sales\ Volume\ of\ Alarms\ 4\ U\ Ltd = \frac{\text{Total Sales Reve}}{\text{Selling Price Per A}}$$

$$Sales\ Volume\ of\ Alarms\ 4\ U\ Ltd = \frac{49{,}000}{17.50}$$

$$\boldsymbol{Sales\ Volume\ of\ Alarms\ 4\ U\ Ltd} = 2{,}800\ units\ s$$

Sales Revenue

This is the amount of money a company makes from the sales of a product/servic needs *the number of units sold* (i.e. how many products/services did they sell?) and

The calculation for this figure is:

$$Sales\ Revenue\ = Price\ per\ \ Number\ of\ units$$

Example:

Fresh Look Ltd want to calculate t of money they made on sunglasses i of sunglasses at a price o .

$$Sales\ Revenue\ = Price\ per\ pair\ of\ sunglasses\ x\ Number\ o$$

$$Sales\ Revenue\ = 8.00\ x\ 30000$$

$$\boldsymbol{Sales\ Revenue} = \textbf{£240,000}$$

Calculation of Fixed Costs and Variable Costs

Once a business has calculated its sales revenue, it is one step closer to being able to work out its gross and net profits. First, however, it needs to calculate its *fixed costs* and *variable costs*.

Fixed Costs

These are the costs of a business that never change, regardless of how many goods/services are produced, advertised or sold. The business could produce 100 units or 1,000 units and the fixed costs would not change.

Fixed costs include council tax, insurance, annual interest (on loans), property rent, salary, equipment rental, electricity.

Focus: Annual Interest

If a company has taken o... £25,000 at an interest rate of 5 per cent, the the business... in... would be:

$$Annual\ interest\ paid = Total\ loan\ amount\ x\ Interes$$

$$Annual\ interest\ paid = 25{,}000\ x\ 0.05$$

$$\mathbf{Annual\ interest\ paid = £1,250}$$

Variable Costs

These are the costs that change with every good/service sold by a business. The m the higher the variable costs.

Variable costs include raw materials, production supplies, by-the-hour contract wo

Difference between Fixed and Variable Costs

A firm's fixed costs are an expense whether they make any money or not and so it between fixed and variable costs.

Chatty People Ltd is a manufacturer of mobile phones. The company rents two fac Chatty People's fixed and variable costs are the following:

Costs for Chatty People Ltd	
Rent of two factories	Electricity for fac
Costs of transporting phones	Raw materia
Salary for 50 regular staff	Supplies for produ
Rental of equipment	Annual interest o

The costs of the business split into ... and Variable Costs:

Costs for Chatty People Ltd	
Fixed Costs	**Variable Co**
Rent of two factories Electricity for factories Salary for 50 regular staff Annual interest on loan Rental of equipment	Raw materia Costs of transportin Supplies for produ

Each time Chatty People Ltd produces a new mobile phone, its variable costs will
materials to produce the phone, plus production supplies and some way of transp
The fixed costs, however, will stay the same no matter how many phones the com
no sales, the firm will still have the fixed costs.

Tip: Fixed or Variable?
When looking at the costs of a business, think about which would likely change depe
goods/services a company produces. Any cost that increases with higher output and
output is a *variable cost*. Any cost that stays the same no matter how many goods/se
produces is considered a *fixed cost*.

Focus: Total Variable Costs and Average Variable Cost

If a business are trying to calculate their Average Variable Costs, but only have the Total of
need the Sales Volume, i.e. quantity of units produced. This would allow the busin
Variable Cost (AVC).

The calculation for this would be:

$$Average\ Variable\ Cost = \frac{Total\ Variable\ Costs}{Sales\ Volume}$$

Likewise, you can calculate the Total Variable Costs from the AVC by using the fol

$$Total\ Variable\ Costs = Average\ Variable\ Cost\ x\ Sales$$

2.2.2. Questions

Please write your answers on a separate piece of paper or in an exercise book.

3. *Many Faces Ltd manufactures novelty masks. They are popular during Hallowee selling price of one mask is £12.50.*

- **a.** *In 2014–15, Many Faces Ltd sold £6,950 worth of masks. Calculate the sale Faces Ltd during 2014–15.*
- **b.** *In 2013–14, Many Faces Ltd sold 13,000 masks. Calculate the sales revenu*

4. *Rearrange the following into fixed costs and variable costs.*

Costs for Many Faces Ltd	
Mortgage on factory	Electric
Salary for 15 regular staff	Raw m
Annual interest on loan	Extra staf
Overall production line costs	Rental o

Fixed Costs	V

2.2.3. Break-even

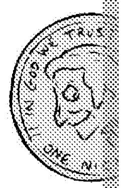
! Key Points Covered

- Contribution
- Break-even Point
- Calculating Break-even
- Margin of Safety
- Interpretation of Break-even Charts
- Limitations of Break-even Analysis

Quantitative Skills Co
QS 3: construct and in
graphical forms
QS 5: calculate cost, re

Break-even is commonly used as a way for firms to calculate how many goods the
become profitable. When the *total costs* of a business's actions meet the *total reve*
products/services, a business has *broken even*. Anything after the break-even poin

Contrib



The first thing needed when calculating break-even is the contribution. This is the difference between what variable costs a company has for making a single product and how much revenue they earn from selling it.

The calculation for this is:

$$\text{Contribution} = \text{Selling Price of one good} - \text{Variable Costs of}$$

Example:
Light On Ltd sells bedside lamps to wholesalers around the UK. The company only
which sells for £16.00 per unit. The variable costs of making one Shine-On lamp in
£3.50 for the supplies to produce it.

The calculation for contribution is:

Contribution for Shine-On lamp = Selling Price of one lamp – Variab

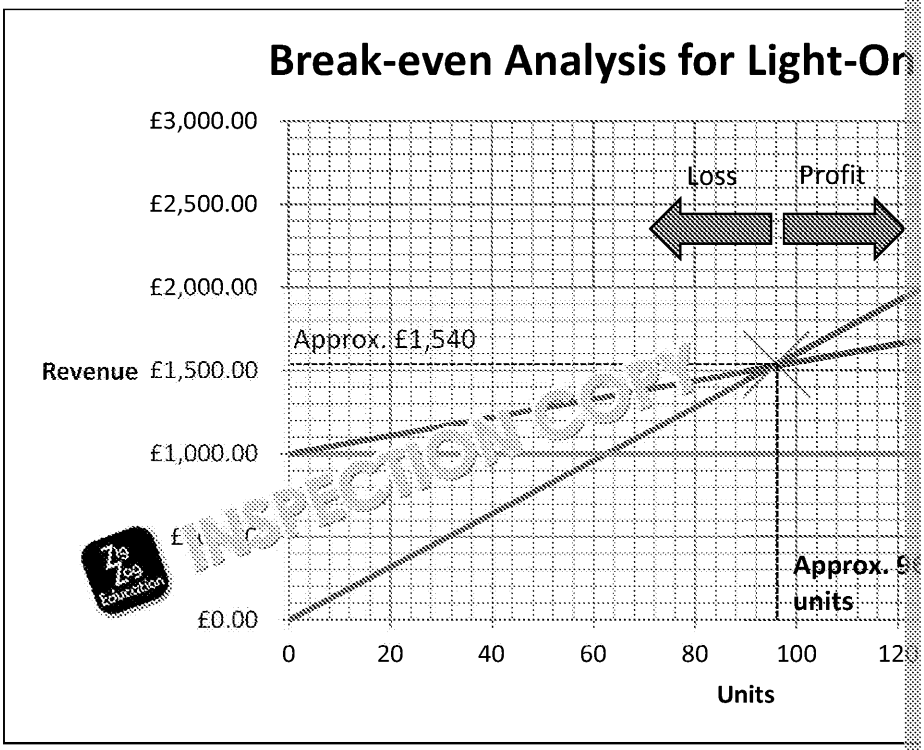
Contribution for Shine-On lamp = 16.00 – (2.00 + 3

Contribution for Shine-On lamp = £10.50

Break-even

The break-even point shows where a company is neither making a profit nor a los
and total revenue cross, i.e. where both figures are exactly the same.

The following diagram is an example break-even graph for Light-On Ltd.



Graph: Break-even Analysis for Light-On Ltd

Anything before the break-even point (i.e. to the left of the cross) shows loss whil
(i.e. to the right of the cross) shows profit. The previous graph tells us that Light-O
lamps before they can start making a profit. Anything less than 96 units will be a l
units, they will make neither a profit nor loss.

What are Total Costs?

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

Total Costs is the sum of Variable Costs and Fixed Costs together.
Fixed Costs always stay the same while Variable Costs are dependent on how man
Variable Cost of a product is £2.50, and you make one product, that is £2.50. How
your Variable Costs will be £25.00.

Calculating Break-even

Take another look at the graph for Light-On Ltd's break-even point. Do you notic
for the break-even point?

Looking at a graph is not always the most accurate way to define break-even. If b
they can calculate break-even using the following formula:

$$Break\ even\ point = \frac{Total\ Fixed\ Costs}{Contribution\ Per\ Unit}$$

Remember that Light-On Ltd sell their lamps for £16.00 each. We calculated in a p
contribution per unit was £10.50. The graph shows Light-On Ltd's Fixed Costs as £

Now that we have this information, we can calculate break-even:

$$Break\ even\ point\ for\ Light\ On\ Ltd = \frac{Total\ Fixed\ C}{Contribution\ Pe}$$

$$= \frac{1000}{10.50}$$

$$\textit{Break-even point for Light On Ltd} = \mathbf{95.24\ units\ (to\ 2}$$

Break-even Always Rounds Up

There is a problem with this figure: a company cannot produce 95.24 units. They c units. Since 95 units is less than break-even (i.e. making a loss), we always *round u* would become 96 units, 15.3 would become 16 units, 180.45 would become 181 u

Using the break-even figure for the number of units, you can also calculate how m using the equation for Total Revenue.

$$Revenue\ at\ break\ even = Sales\ Volume\ [at\ break\ even\ point]$$

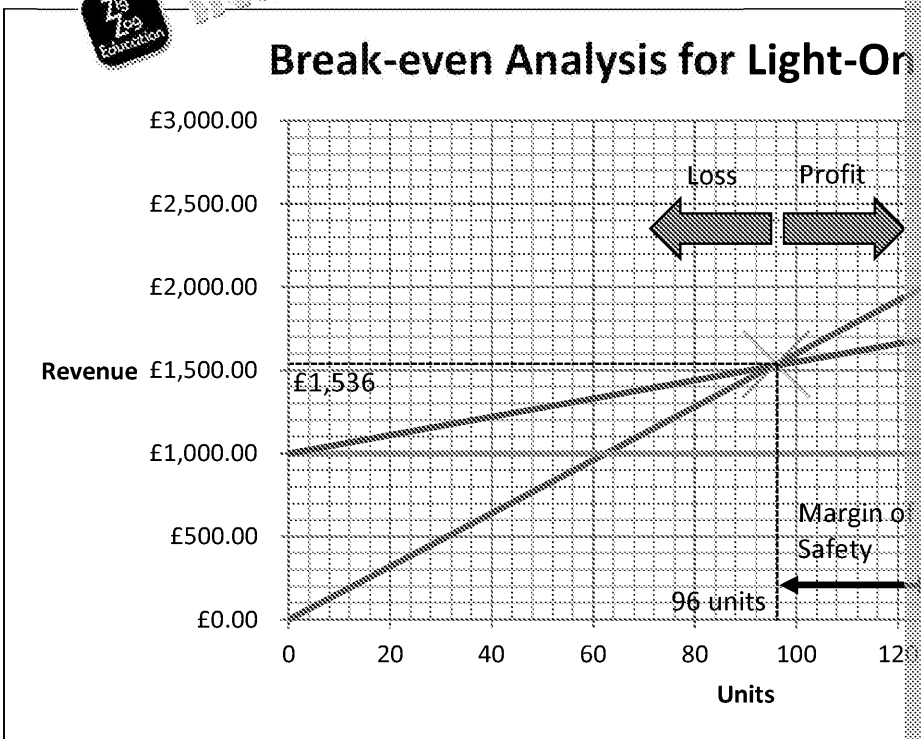
$$Revenue\ at\ break\ even = 96\ x\ 16.00$$

$$\boldsymbol{Revenue\ at\ break\ even} = \pounds\mathbf{1,536}$$

Margin of Safety

This shows the difference between the break-even point that a company needs to and the actual output the company is making.

Example:



Graph: Break-even Analysis with Margin of Safety for Light-On

If the break-even point for Light-On Ltd is 96 units, but the company has actually calculate the margin of safety using the following equ

$$Margin\ of\ Safety = Actual\ Sales\ Volume - Break$$

$$Margin\ of\ Safety = 128 - 96$$

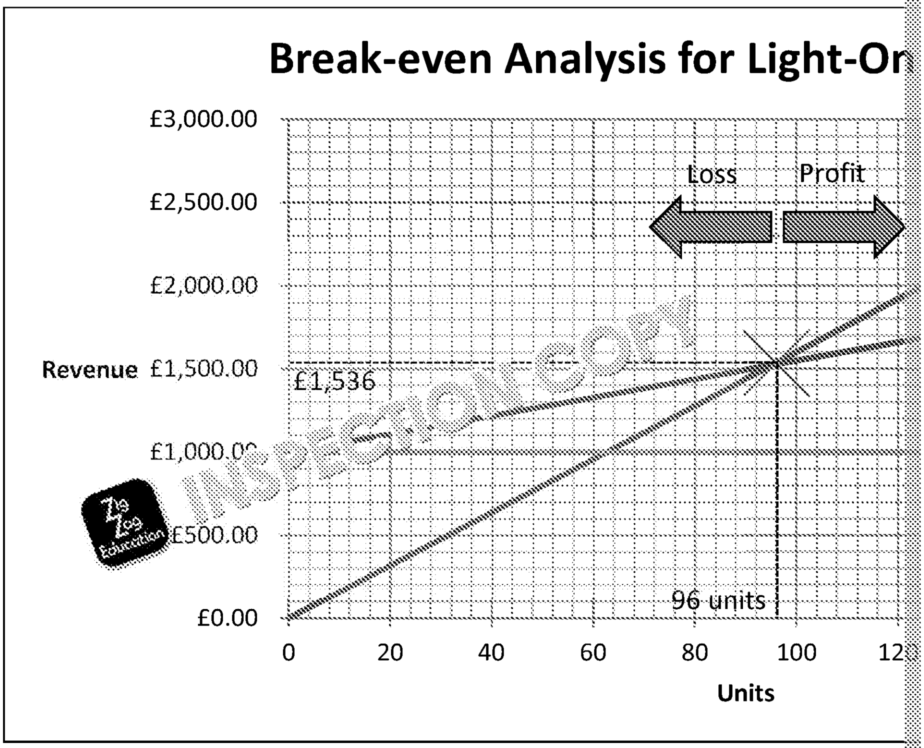
$$\boldsymbol{Margin\ of\ Safety = 32}$$

Below shows a table of different margins of safety for Light-On Ltd.

Break-even point	Actual number of sales	Margin
96	160	
96	146	
96	128	
96	101	
96	96	

Interpreting Break-even Charts

Take another look at the break-even chart for Light-On Ltd.



You now understand how to calculate Total Costs, Total Revenue, Contribution, M
Finally, you can calculate Total Variable Costs using the following equation:

$$Total\ Variable\ Costs = Variable\ Cost\ per\ unit\ x\ Sales$$

However, if you do not know the original Variable Cost per unit, you can use the f

$$Total\ Variable\ Costs = Total\ Costs - Fixed\ Cost$$

In the case of Light-On Ltd, Fixed Costs stay at £1,000 no matter how many units t
because of the Total Variable Costs, and so, if you subtract the Fixed Costs from t
the Total Variable Costs!

You can use the break-even graph to find all of these figures.

Example:
There is another line drawn on the graph at 140 units. Follow this to the Fixed Cos
lines and you have the following:

Units: 140
Total Costs: £1,770.00
Total Revenue: £2,240.00
Total Variable Cost[illegible] (i.e. Total Costs – Fixed Costs)

Limitations of Break-even Analysis

Analysing break-even point is an integral part in running a business. It makes the data easy to view and understand, which helps a business make decisions and understand the consequences of those decisions (such as introducing a product to the market). There are, however, limitations to the usefulness of break-even:

- The method only takes into account elements that the firm can control, such as price per unit and the number of goods produced. It does not consider any external factors
- It is difficult to look at more than one product at a time. Most companies have a portfolio of products/services which would, therefore, n
- All costs include only those that a business can pl[illegible]. They do not invo
- Businesses often buy in bulk. If a firm neg[illegible]es [illegible]eal with its supplier th this would then change the graph [illegible] w[illegible]d not increase by the same a
- Break-even graphs only r[illegible] a company's products/services all se
- Just because a b[illegible] [illegible]uce the goods/services, it does not mean the
- Brea[illegible]n [illegible]ow that revenue increases as price increases. Howev de[illegible]nce the price gets too high

2.2.3. Questions

Please write your answers on a separate piece of paper or in an exercise book.

5. *Many Faces Ltd manufactures novelty masks. The selling price of one mask is £1 mask add up to £4.00. Total fixed costs are £500.*

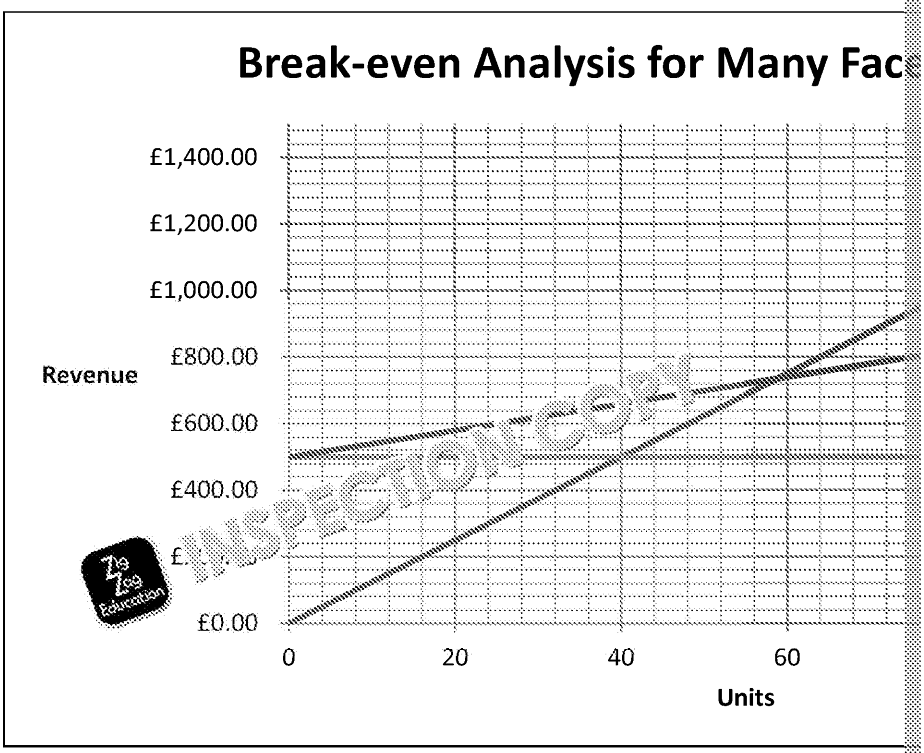
a. *Calculate the contribution per mask.*

b. *Calculate the break-even point.*

c. *The variable costs have now changed. Study the graph below and:*

i. *Label each line on the graph*

ii. *Identify the break-even point*



6. *Identify and explain two limitations of the break-even graph.*

2.2.4. Budgets

! ***Key Points Covered***

- Purposes of Budgets
- Types of Budget
- Variance Analysis
- Difficulties of Budgeting

Quantitative Skills Co
QS 2: calculate, use an
percentage changes

Purposes of Budgets

The main purpose of any budget is to ensure that the company has complete control over its incomings and outgoings. This way, it can make sure to earn a profit!

Planning

Budgets help the business prepare so that they can achieve their main aims and objectives. If, for example, a business's aim is to increase productivity by 20 per cent, it can plan out how to support this using its budget.

Forecasting

Businesses use cash-flow forecasts in order to predict what funds they will have available to pay which bills on which month. These forecasts allow businesses to make sure that they do not go under during periods of low sa

Communications

Firms use budgets as a way to notify their employees of what targets they need to in order to keep management informed of business aims and what spending they months or year.

Motivation

Once employees know what is expected of them, following a budget allows comp employee/management performance. This helps when delivering appraisals – com way to decide who to watch more closely and who to reward (either financially or

Types of Budget

Historical Figures

This type of budget uses the figures from previous periods (i.e. months, years, etc budget. A business that gave its marketing department £1,000, for example, would year. The figure may even increase due to inflation.

The benefits of historical figure budgeting include:

- It is efficient to implement as businesses can base their budgets on those
- Managers can plan better for the future as they clearly understand how m

Zero-based

This budget clears all budgets every period (i.e. every year, every six months) This then means that each department must present a proposal to the company t and to prove why.

The benefits of zero-based budgeting include:

- It stops companies from creating unnecessarily large budgets
- Departments can only make purchases because they have proven there is

Variance Analysis

Businesses use this form of analysis after a budgeting period (i.e. after six months
spending compared with the budget they set out to meet. Analysis can be either
company's sales department is budgeted £2,500, for example, and they end up on
would be £500 favourable. If the department spent £3,500, however, the analysis w

Examples of Variance Analysis:

Budget	Actual Spend	Variance
£1,000	£1,200	£200
£500	£2,000	£1,500
£2,000	£1,700	£300
£300	[illegible]	£180
£5,000	[illegible]	£700

Percentage Change

Businesses [illegible] work in percentages – they put things into perspective when ra
the previous table's top budget as an example:

£1,000 was the budget that the department had to spend. Their actual spend was
£200, but what would that be in percentage terms?

$$\text{Percentage Change} = \frac{\text{Difference}}{\text{Original figure}} \times 100$$

$$\text{Percentage Change for top budget} = \frac{\text{Variance}}{\text{Budget}} \times$$

$$\text{Percentage Change for top budget} = \frac{200}{1000} \times 10$$

$$\text{Percentage Change for top budget} = 0.2 \times 10$$

Percentage Change for top budget = **20 per cen**

Difficulties of Budgeting

Historic Budgeting

While one of the benefits of historic budgeting is that managers can quickly plan
results, this is also where the method can fail:

- Managers can become complacent with their planning and so miss the fa
  as much money as in previous years. This mon[illegible] have been better
- If departments keep receiving the sam[illegible] they may feel expected
  budgets would decrease in th[illegible] years. This could lead to unnece
  higher expenses for [illegible]

Zero-based Budgeting

Companies [illegible]t for zero-based budgeting, instead of historical budgeting, do
departments can prove a genuine reason for their spending. This form also has its

- Zero-based budgeting takes a long time to implement, which in itself is a
- Budget proposals can be very short-sighted: if a business is only looking
  in budgets required to improve a department, even if it may bring more r

The Times Are Always A-Changing

Budgets are rarely exact. In fact, they are less an exact science and more an amalg
departments need less cash than others. This changes from year to year – often e
businesses should be realistic with their budgeting. If a budget is too tight, a depa
overshoot it. If a budget is too generous, on the other hand, departments will eith
spend it on unnecessary items just to make sure the budget is not cut next year!

As well as being realistic, businesses need to be open to the fact that circumstanc
may creep in that send a budget over the edge. Businesses need to understand, th
(i.e. the line that a budget must not cross). This line probably changes from budge
company. A variance analysis that shows £150 adverse may pose a serious proble
business, for example, but may be completely normal for a large corporation.

2.2.4. Questions

Please write your answers on a separate piece of paper or in an exercise book.

7. *Calculate the variance analysis of:*

Budget	Actual Spend	Variance	
£4,000	£4,500		
£4,000	£3,900		
£2,500	£2,501		
£25,000	£2,500		
£3,600	£2,950		

8. *Identify one benefit and one drawback of:*

a. *Historical-figure budgeting*

b. *Zero-based budgeting*

Focus: Budgeting

Question:
Evaluate the validity of Herman Heyns's statement, comparing any business benefits of using budgets to the drawbacks that Heyns mentions.

Budgets Tighten as C

Not everyone believes in th
Indeed, some businesses see
creativity and innovation. If
w... p... up in the financial s
... things are going to cost
should take, etc.), many argu
harm than good. Herman H
School of Management belie
'obsolete given today's ec
documents that are time-con
little predictive value, subject
quite frankly, out of date
implemented'.

Source:Inc.com http://www.inc.com/

2.2. Keywords

Sales forecast:	A prediction of the sales a company will make in t
Sales volume:	The number of units sold
Sales revenue:	The amount of cash generated by selling product
Fixed costs:	Costs that do not change with the number of goo
Variable costs:	Costs that change according to the number of go
Disposable income:	The amount of cash consumers have available to s is absolutely necessary
Contribution:	The difference between the variable costs of prod amount of revenue a company earns from selling
Break-even:	The point where total costs of producing a good/s revenue earned are equal (i.e. where the lines on t
Historical b[illegible]:	Companies create a budget based on those of pre
Zero-based budget:	All departments in a company start with no budg company what they need in order to qualify for a
Variance analysis:	A method to demonstrate how much of its budge

2.2. Answers

1. **Identify and explain three factors that can cause sales forecasts to i**
Students could identify and explain any three of the following:
   - ***Consumer Trends:*** *if a product suddenly falls out of favour, or e company's sales forecast can be significantly affected*
   - ***Economic Variables:*** *an example might be that in times of econo be looking for so many cheaply made products and so this would manufacturers*
   - ***Competition:*** *companies should stay abreast of their competitio case one firm swoops into the market with a new, highly popular*
   - ***External Factors:*** *this may include anythi om sudden outbre political struggle*

2. **The number of sales fore November and December were 200,000. In realit , the sales only came to 140,000 for bot reason y in November and December were much lowe**
Reaso include:
   - *ecasts are less accurate when projected over long periods of t*
   - *They are only correct to the best of a business's own knowledge*

   Students may also wish to identify any factors that could have affected the
   - *Competition entered the market, which turned consumers away f*
   - *External factors significantly affected the company's supplier*
   - *Economic variables could have changed the amount of disposabl*
   - *Consumer trends might put the company's products/services out November/December*

3. **Many Faces Ltd manufactures novelty masks. They are popular dur dress parties. The selling price of one mask is £12.50.**
   a. **In 2014–15, Many Faces Ltd sold £6,950 worth of masks. Calcul sold by Many Faces Ltd during 2014–15.**

$$Sales\ Volume = \frac{Total\ Sales\ Revenue}{Selling\ Price\ Per\ Uni}$$

$$Sales\ Volume = \frac{6950}{12.50}$$

$$Sales\ Volume = 556\ units$$

   b. **In 2013–14, Many Faces Ltd sold 13,000 m . Calculate the sa**

$$Sales\ Reve \quad per\ unit\ x\ Number\ of\ u$$

$$Sales\ Revenue = 12.50\ x\ 13000$$

$$Sales\ Revenue = £162{,}500$$

4. **Rearrange the following into fixed costs and variable costs.**

Fixed Costs	Variable Costs
Mortgage on factory	*Production line costs*
Salary for 15 regular staff	*Raw materials for masks*
Annual interest on loan	*Extra staff during busy season*
Electricity and other bills	
Rental of regular equipment	

5. **The variable costs of one mask add up to £4.00. Total fixed costs ar**
   a. **Calculate the contribution per mask.**

$$Contribution = Selling\ Price\ of\ one\ good - Variable\ C$$

$$Contribution = 12.50 - 4$$

$$Contribution = £8.50$$

   b. **Calculate the break-even point.**

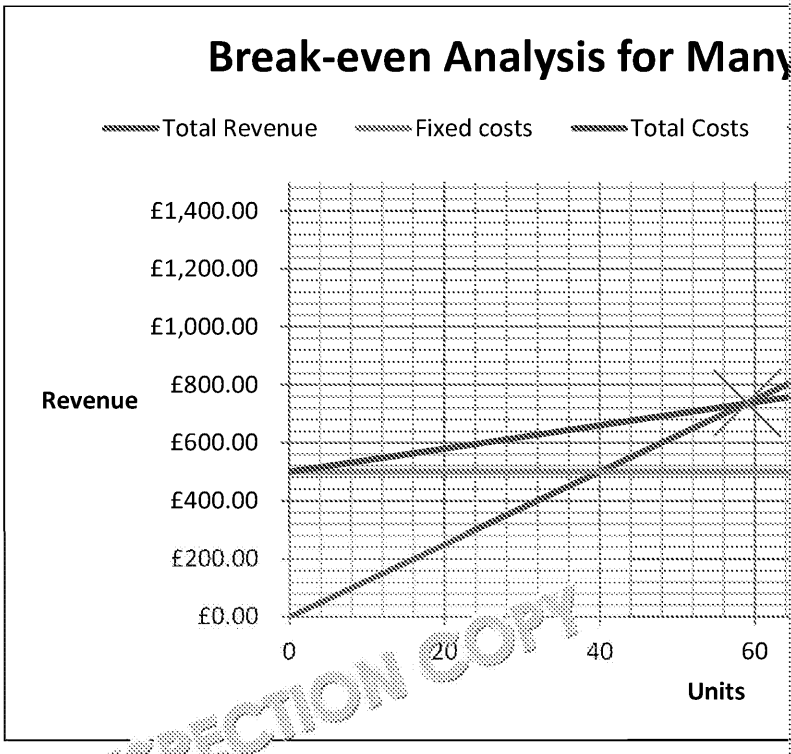
$$Break\ even\ point = \frac{Total\ Fixed\ Costs}{Contribution\ Per\ Un}$$

$$Break\ even\ point = \frac{500}{8.50}$$

$$Break\ even\ point = 58.82$$

$$Break\ even\ point = 59\ units$$

   c. **The variable costs have now changed. Study the graph below ar**
      i. **Label each line on the graph**
      ii. **Identify the break-even point**



6. **Identify and explain two limitations of the break-even graph.**
   Limitations might include:
   - *Break-even charts work best when analysing just one product/service than one product, then, would find break-even a difficult method to us*
   - *A company's break-even analysis assumes that all products manufact rarely the case and so does not give an accurate impression of the bus*
   - *Break-even charts do not include unforeseen costs that a company mi were included in these graphs, the break-even point would likely have*
   - *Likewise, break-even charts only take into account those factors that not consider external factors.*

7. **Calculate the variance analysis of:**

Budget	Actual Spend	Variance	Adv
£4,000	*£4,500*	*500*	
£4,000	*£3,900*	*100*	
£2,500	*£2,501*	*1*	
£25,000	*£2,500*	*22,500*	
£3,600	*£2,950*	*650*	

8. **Identify one benefit and one drawback of:**

   a. **Historical-figure budgeting:**

   Benefits include:
   - *It's an efficient system since companies draw on figures from pre*
   - *Managers have a tight understanding of their available cash for*

   Drawbacks include:
   - *Companies can become complacent in their allocation of funds, w [illegible] department requires it*
   - *Departments that receive the same budget year after year may fe*

   b. **Zero-based budgeting**

   Benefits include:
   - *Stops companies from creating unnecessarily large budgets*
   - *Purchases are only made once there is a genuine, proven req*

   Drawbacks include:
   - *This system is time-consuming, which is a cost to the business*
   - *Companies can become too budget-focused, losing sight of th business is ever to improve (and, therefore, bring more reven*

2.3. Managing Finance

2.3.1. Profit

! ***Key Points Covered***

- Calculating Gross, Operating and Net Profit
- Statement of Comprehensive Income
- Comparing Profitability
- Increasing Profitability and the Difference between Cash and Profit

Quantitative Skills Co
QS 1: calculate, use an
QS 2: calculate, use an

When analysing the success of a bu... we often talk about three types of profi
profit for the year, (i.e. *net p*...

Calculat... Profits

Gross Prof...

Businesses find gross profit by subtracting the *cost of sales (COS)* of producing go *revenue* they make for the company. Gross profit allows a company to calculate th the raw materials needed to produce a good/service.

$$Gross\ Profit = Revenue - COS$$

Let's use an example:

Sparkling Crystal Ltd is a company that produces glasses for fine-dining restaurants. Its COS includes raw materials for manufacturing the glasses, supplies needed for the production line and labour of company staff working on each glas

All together, the raw materials, supplies and labour amounted to £6,000 for the ye Sparkling Crystal Ltd was £14,000.

$$Gross\ Profit = Revenue - COS$$

$$Gross\ Profit = 14{,}000 - 6{,}000$$

$$\mathbf{Gross\ Profit} = £8{,}000$$

This gross profit for 2014–15 shows that Sparkling Crystal ... were able to add va

Cost of Sales for All

If a company is a retailer (such as ... shop), instead of a manufacturer or ser calculated by using the a... stock they started with (e.g. at the beginning o the amount ... have at the end (e.g. at the end of the year).

Opening stock
+ Stock bought
–Closing stock
= Cost of Sales

Cost of sales only includes the stock which was actually used during the financial p hopefully be sold next financial period.

Operating Profit

More than a statement of how much value a business adds to their raw materials, left over after other operating costs (also known as fixed costs) have also been de costs to the business of their key activities, such as day-to-day administration.

$$Operating\ Profit = Gross\ Profit - Other\ Operating\ Ex$$

Many business analysts prefer to look at operating profit rather than gross profit idea of how much profit the business has really made. A firm might make £20,000 operating costs are £21,000, then that figure is not really worth much.

Net Profit

This third profit is also known as the 'bottom line' because it is generally found on *statement of comprehensive income*. Net profit is calculated using a company's *ope*

$$Net\ Profit = Operating\ Profit - Interest$$

This is the final amount before any tax or dividends are paid. Investors prefer to lo any other figure because it gives the best indication of how much profit a compan operating and gross profits are both positive, a negative net profit would make a to investors.

Statement of Comprehensive Income

This statement, also known as the 'Profit and Loss Account', gives a breakdown of profits. Let's take a look at these figures in action.

Profit and Loss Account for Sparkling Crystal Ltd in 20

	Expenses
Sales Revenue (a.k.a. Turnover)	
Raw materials	£2,000
Production supplies	£1,000
Labour costs	£3,000
Cost of Sales	**£6,000**
GROSS PROFIT	
Business expenses	£1,900
Administrative expenses	£1,100
Other Operating Expenses	**£3,000**
OPERATING PROFIT	
Interest Paid	£965
NET PROFIT	

The profit and loss account shows that Sparkling Crystal Ltd made £14,000 in sale

- Subtract cost of sales (sum of raw materials, production supplies and lab of £[illegible]
- Subtract other operating expenses (sum of business expenses and admini profit to find the operating profit of £5,000
- Finally, subtract interest paid from the operating profit in order to find the profit, which comes to £4,035

Profitability

You can use the profit and loss account as a way to calculate a firm's profitability, into profit. This is shown as a ratio: how much of the company's sales revenue rep

These ratios (*gross profit margin*, *operating profit margin* and *net profit margin*) he as they give a more informed idea of how much profit the firm can expect depend they make.

Gross Profit Margin

This shows how much of a company's sales revenue represents actual gross profit Crystal Ltd:

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

$$\text{Gross Profit Margin} = \frac{8000}{14000} \times 100$$

$$\textbf{Gross Profit Margin} = \mathbf{57.14}\ \boldsymbol{per\ cent}$$

This calculation shows us that for every £1.00 of sales revenue for Sparkling Crysta represents gross profit, i.e. every pound represents £0.57 of gross profit.

Operating Profit Margin

This shows how much of a company's sales revenue represents actual operating p Crystal Ltd:

$$Operating\ Profit\ Margin = \frac{Operating\ Profit}{Revenue} \times 1$$

$$Operating\ Profit\ Margin = \frac{5000}{14000} \times 100$$

$$\boldsymbol{Operating\ Profit\ Margin = 35.71\ per\ cent}$$

This calculation shows us that for every £1.00 of sales revenue for Sparkling Crysta represents operating profit, i.e. every pound represents £0.36 (rounded up) of ope

Net Profit Margin

This shows how much of a company's sales revenue represents actual net profit. S Crystal Ltd:

$$Net\ Profit\ Margin = \frac{Net\ Profit}{Revenue} \times 100$$

$$Net\ Profit\ Margin = \frac{4035}{14000} \times 100$$

$$\boldsymbol{Net\ Profit\ Margin = 28.82\ per\ cent}$$

This calculation shows us that for every £1.00 of sales revenue for Sparkling Crysta represents net profit, i.e. every pound represents £0.29 (rounded up) of net profit.

Comparing Profitability

Gross profit, operating profit, net profit. These figures are almost meaningless wit
going to learn anything from these numbers, they need to be compared somehow

Profit and Loss Accounts for Sparkling Crystal L

	2014–15		2013
	Expenses	**Income**	**Expenses**
Sales Revenue (a.k.a. Turnover)		£14,000	
Cost of Sales	£6,000		£5,000
GROSS PROFIT		£[illegible]000	
OPERATING PROFIT		£5,000	
NET PROFIT		**£4,035**	

The previous [illegible] basic profit and loss accounts for Sparkling Crystal Ltd c
2014–15. The [illegible] profit (bottom line) is much lower in 2013–14 due to the numbe
to generate.

The profit margins for 2013–14 are calculated as:

$$Gross\ Profit\ Margin = \frac{Gross\ Profit}{Revenue} \times 100$$

$$Gross\ Profit\ Margin = \frac{5000}{10000} \times 100$$

$$\boldsymbol{Gross\ Profit\ Margin = 50\ per\ cent}$$

Fraction Talk
Sometimes in business you might hear people talk in fractions instead of percenta
profit margin as an example:

If *£5,000* of Sparkling Crystal Ltd's revenue is *gross profit*, and the firm's *revenue* e
Sparkling Crystal Ltd's revenue is gross profit.
Another way to say the same thing would be that *half of Sparkling Crystal Ltd's rev*

Make sure you practise your understanding of fractions before exam day.

$$Operating\ Profit\ Margin = \frac{Operating\ Profit}{Revenue} \times$$

$$Operating\ Profit\ Margin = \frac{3200}{10000} \times 100$$

$$\boldsymbol{Operating\ Profit\ Margin = 32\ per\ cent}$$

$$Net\ Profit\ Margin = \frac{Net\ Profit}{Revenue} \times 100$$

$$Net\ Profit\ Margin = \frac{2515}{10000} \times 100$$

$$\boldsymbol{Net\ Profit\ Margin = 25.15\ per\ cent}$$

Comparing these three figures with the three before, not only did Sparkling Cryst
2014–15 but the company was also more profitable.

There's Always Another Way
Companies can get the even-bigger picture on their profitability by comparing th competitors – that is if other companies publish their profit and loss accounts for use statistics for their market as a benchmark for how profitable they should be co competition.

Increasing Profitability and the Difference between Cash a

The long-term aim for almost any company is to make a profit. This is true for the trader all the way up to the multinational corporation. Companies, therefore, need their profitability.

Examples of ways to achieve this include:

- Decrease cost of sales by reducing the amount of raw materials needed f
- Generate higher sales by increasing promotion of products/services
- Increase efficiency of workforce
- Provided there is still demand, the company could produce more goods/s further sales
- Evaluate how much of the company's day-to-day expenses are essential

As explained in the previous sections, profit is the prime, long-term objective for a overall success of a firm while cash, on the other hand, tells us how efficient a com

Cash flow is integral to the day-to-day running of a business. Regardless of how m the long run, if they do not have enough cash to pay their suppliers from one mo term), they will come into serious problems. These issues could lead to the busine trust them, or, worse, going bankrupt from having so much more expense than in

Let's use Sparkling Crystal Ltd as an example:

Profit and Loss Account for Sparkling Crystal Ltd durin

	Expenses
Sales Revenue (a.k.a. Turnover)	
Cost of Sales	£6,000
GROSS PROFIT	
OPERATING PROFIT	
NET PROFIT	

The company had a net profit of £4,035. However, take a look at their incomings a

Incomings and Outgoings for Sparkling Crystal Ltd 2

Cash received (Incoming)	
Cash paid (Outgoing)	
Net Cash Flow	

Sparkling Crystal Ltd's net cash flow is positive, but it is much lower than their net they, and most firms, do business.

Certain customers, for example, will have longer payment plans than others (espe in bulk!). Some suppliers will also demand Sparkling Crystal Ltd to pay quickly (i.e. might give the company a couple of months. All of these inflows and outflows aff has available in order to pay its short-term debts.

Remember: profit is the goal in the long term, but a company must have cash free actions. When it comes to the actual running of a business, profit is important, bu

Remember Me:
The following three calculations will be important come exam time. Make sure yo and have them memorised!

$$\text{Gross Profit Margin} = \frac{Gross\ Profit}{Revenue} x\ 100$$

$$\text{Operating Profit Margin} = \frac{Operating\ Profit}{Revenue} x\ 10$$

$$\text{Net Profit Margin} = \frac{Net\ Profit}{Revenue} x\ 100$$

2.3.1. Questions

Please write your answers on a separate piece of paper or in an exercise book.

1. *Sweet Things Ltd is a baker of cakes, tarts and biscuits. The company spent £54, production supplies for the year 2014–15, while sales revenue came to £135,000*
   - **a.** *Calculate the company's gross profit for 2014–15.*
   - **b.** *Complete the following profit and loss account for Sweet Things Ltd.*

Profit and Loss Account for Sweet Things Ltd in 2

	Expenses
Sales Revenue (a.k.a. Turnover)	
Ingredients	£13,000
Production supplies	£6,000
Labour costs	£35,000
Cost of Sales	
GROSS PROFIT	
Business expenses	£8,000
Administrative expenses	£5,000
Total Other Operating Expenses	**£13,000**
OPERATING PROFIT	
Interest Paid	£2,650
NET PROFIT	

2. *The table below shows the incomings and outgoings for Sweet Things Ltd.*
   - **a.** *Calculate the net cash flow of 2014–15.*

Incomings and Outgoings for Sweet Things Ltd 2014–15

	£
Cash received (Incoming)	135,000
Cash paid (Outgoing)	54,100
Net Cash Flow	

   - **b.** *Identify two reasons why a company's net cash flow can differ from its net*

2.3.2. Liquidity

! Key Points Covered

- Statement of Financial Position
- Calculating Liquidity
- Improving Liquidity
- The Working Capital Cycle

Quantitative Skills Co
QS 1: calculate, use an

While profitability shows the level of success a business can expect in the long ter likeliness that they will be able to pay back their short-term liabilities. Firms that h cash available for their day-to-day expenses than [illegible] lower liquidity.

We can find the liquidity of a business [illegible] their balance sheet.

Statement of Financial Position

This statement, also known as a *balance sheet*, shows the financial status of a busi (their *assets*) [illegible] what they owe (their *liabilities*).

Where Eagles Dare Ltd is a company that manufactures parachutes for skydivers. include designing parachutes, purchasing raw materials to produce them, managi their factories, transporting goods and promoting their products.

The following shows a statement of financial position for Where Eagles Dare Ltd.

Statement of Financial Position for Where Eagles Dare Ltd

	2014–15 (£000s)	**2013–14 (£000s)**
FIXED ASSETS		
Factory	100	100
Office	65	65
Machinery	30	30
TOTAL FIXED ASSETS	195	195
CURRENT ASSETS		
Cash	40	20
Stock	20	60
Debtors	10	15
TOTAL CURRENT ASSETS	70	95
CURRENT LIABILITIES		
Overdraft	(5)	(7)
Creditors	[illegible]	(25)
TOTAL CURRENT LIABILITIES	(35)	(32)
NET CURRENT ASSETS	35	63
LONG-TERM LIABILITIES (LTL)		
Bank loan	(75)	(95)
Property lease	(20)	(20)
TOTAL LTL	(95)	(115)
NET ASSETS	**135**	**143**
EQUITY		
Owner investment	60	60
Retained profits	75	83
TOTAL EQUITY	**135**	**143**

The statement of financial position shows the balance between a firm's assets and make up a financial position include:

- **Fixed Assets:** things such as property and equipment that are owned by the
- **Current Assets:** these are assets that a business own for up to a year, such as are easier and quicker to convert into cash than fixed assets
- **Current Liabilities:** debts that a company has and that will be paid within the
- **Long-term Liabilities:** debts that a company has and that will be paid in mo
- **Net Current Assets:** also known as *Working Capital*, this is the finance availa to-day processes. It is calculated with the equation: Current Assets – Current
- **Net Assets:** this is what is left once all liabilities have been subtracted from a Fixed Assets + Net Current Assets – Long-term Liabilities

Calculating Liquidity

Businesses calculate their liquidity using r

Current Ratio

This first rati s c ssets and current liabilities to show what cash a busin its short-te s.

Let's use Where Eagles Dare Ltd as an example:

$$Current\ Ratio\ for\ 2014\text{–}15 = \frac{Current\ Assets}{Current\ Liabilitie}$$

$$Current\ Ratio\ for\ 2014\text{–}15 = \frac{70}{35}$$

$$\boldsymbol{Current\ Ratio\ for\ 2014\text{–}15 = 2}$$

The current ratio is 2:1, which tells us that Where Eagles Dare Ltd have £2.00 in as They have plenty of finance available to pay their short-term debts.

As a general rule, companies aim for between 1.5:1 and 2:1 as an optimal ratio. A detrimental to a business since they will not be able to pay off their short-term de high ratio may mean that the company has too much cash wrapped up in assets t to make a profit in the long run.

Acid Test Ratio

Businesses have to accept that some of their assets may not sell. The acid test rati takes this into account by removing a company's inventory from their current asse most liquid of assets, i.e. the ones that are most likely (and are quickest) to conve

Let's use Where Eagles Dare Ltd as an example again:

$$Acid\ Test\ Ratio\ for\ 2014\text{–}15 = \frac{Current\ Assets - Inve}{Current\ Liabiliti}$$

$$Acid\ Test\ Ratio\ for\ 2014\text{–}15 = \frac{70 - 20}{35}$$

$$\boldsymbol{Acid\ Test\ Ratio\ for\ 2014\text{–}15 = 1.43\ (rounded\ up\ t}$$

The acid tes s 1.43:1, which tells us that Where Eagles Dare Ltd has £1.43 in £1.00 of liabilities. Just like with the current ratio, the company has plenty of finan short-term debts.

The optimal figure for a company's acid test ratio falls between 0.75 and 1.00. Mu acid test ratio shows that the business will have problems affording to pay off its s lead to serious financial troubles. If the acid test ratio is significantly high, a busine on current assets that could be better spent on fixed assets (such as new factory e assets may not help in the short term, but could create a lot of profit in the long r new factory, it will be able to produce more goods, make more sales and, as a res

Improving Liquidity

If a business has a considerably low current or acid test ratio, it can improve this in

- Sell off fewer current assets
- Hold back more cash, rather than investing in fixed assets
- Consider leasing some of its property, especially if it is not using it to full
- The business could even sell off a fixed asset and then rent it back in orde

If a business's current or acid test ratio is high, it can address this in several ways,

- Sell off more current assets, which are holding valuable cash for the comp
- Use the available cash to invest in property or equipment, which could lea therefore, sales
- Change payback period with debtors so that the finance arrives more quic invest this cash into its fixed assets.

The Working Capital Cycle

We now understand that while profit is important, cash is king. The main reason f from negative cash flow, so companies must have a firm understanding of the

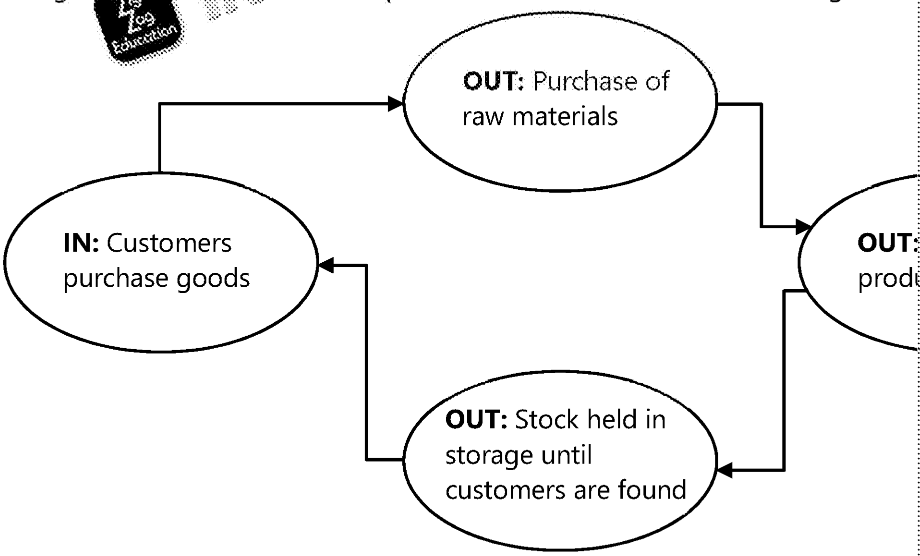


Diagram: The Working Capital Cycle

Each inflow and outflow of cash has its own time period. The time period for payi materials, for instance, may be much shorter than the pay period the firm gives its

$$Length\ of\ Working\ Capital\ Cycle = Time\ Goods\ Held + Time\ for\ Receivables\ Paid$$

Let's look at the working capital cycle for Where Eagles Dare Ltd:
The company holds on to goods for 60 days. It gives its customers 30 days to pay company's suppliers expect to be paid in 21 days after any order.

Using these figures, we can calculate the working capital cycle for Where Eagles D

$$Length\ of\ Working\ Capital\ Cycle = Time\ Goods\ Held + Time\ for\ Receivables\ Paid -$$

$$Length\ of\ Working\ Capital\ Cycle = 60 + 30 - 21$$

$$\boldsymbol{Length\ of\ Working\ Capital\ Cycle = 69\ days}$$

This result shows that it takes Where Eagles Dare Ltd up to 69 days before it can t debtors (customers that owe money) into cash. Businesses all have different work for example, would buy in fresh fruit and vegetables and sell them soon after stoc manufacturer, on the other hand, may have a very long working capital cycle. It is to keep track of how their working capital cycles change over time. If the cycle to business could lose out since then it will not have enough cash available when the

Remember Me:
The following two calculations will be important come exam time. Make sure you have them memorised!

$$Current\ Ratio\ for\ 2014\text{–}15 = \frac{Current\ Assets}{Current\ Liabilitie}$$

$$Acid\ Test\ Ratio\ for\ 2014\text{–}15 = \frac{Current\ Assets - Inve}{Current\ Liabiliti}$$

2.3.2. Questions

Please write your answers on a separate piece of paper or in your exercise book.

3. *Sweet Things Ltd holds on to its products for five days. The firm gives its custom for their purchases while the [illegible] suppliers (who provide the ingredients) any order.*
   - **a.** *Calculate the [illegible] capital cycle for Sweet Things Ltd.*
   - **b.** *Explain what the answer to **3.a.** means.*

4. *In this section, we talked mostly about profit and loss for Eagles Dare Ltd during*

Statement of Financial Position for Where Eagles D

	2014–15 (£000s)	
FIXED ASSETS		
Factory	100	
Office	65	
Machinery	30	
TOTAL FIXED ASSETS	195	
CURRENT ASSETS		
Cash	40	
Stock	20	
Debtors	10	
TOTAL CURRENT ASSETS	70	
CURRENT LIABILITIES		
Overdraft	(5)	
Creditors	(30)	
TOTAL CURRENT LIABILITIES	(35)	
NET CURRENT ASSETS	35	
LONG-TERM LIABILITIES (LTL)		
Bank loan	(75)	
Property lease	(20)	
TOTAL LTL	(95)	
NET ASSETS	**135**	
EQUITY		
Owner investment	60	
Retained profits	75	
TOTAL EQUITY	**135**	

- **a.** *Calculate the current ratio for Where Eagles Dare Ltd during 2013–14.*
- **b.** *Calculate the acid test ratio for Where Eagles Dare Ltd during 2013–14.*
- **c.** *Explain the main difference between current ratio and acid test ratio.*

2.3.3. Business Failure

! ***Key Points Covered***

- Internal and External Causes of Business Failure
- Financial and No

The main culprit for why businesses fail is poor cash flow management. Without th
become unpaid bills and eventually bad debts. There are many other factors, howe
to failure, however, which split into internal and external.

Internal Causes of Business Failure

Financial

- **Efficiency:** businesses must control their working capital. This ensures th
assets to convert to cash so that they can pay their day-to-day expenses
- **Planning:** proficient planning, albeit a short-term objective, is integral for a busine
young businesses must plan their cash flow carefully so that it does not a
businesses should invest in their own futures so that profit is gained.

Non-financial

- **Communication:** (employer-to-employee, employee-to-employer, etc.) is an integral part of running a business. If everyone is not clear on a business's objectives, failure is far more likely as a result.
- **Efficiency:** businesses that use their raw materials in the most cost-effective manner possible benefit from having low cost of sales and, therefore, higher profits. Businesses that waste their raw materials, on the other hand, can suffer from producing expensive products that no one can afford (or want to) buy.
- **Marketing:** firms need to promote their goods to as many customers as possible – and to the right people! If done incorrectly, a business could suffer by trying (and failing) to sell to the wrong people.
- **Innovation:** businesses that fail to stay up to date with their markets (i.e. what consumers want and what they need) will find it diffic
business will introduce a better product/service and any firms left behin

External Causes of Business Failure

Financial

- **Economic recession:** a business must have a game plan for unforeseen
financial crisis. Any business that relied on the way things were before th
borrowing, high spending, etc.) would have suffered greatly once the ec
- **Currency strength:** many businesses purchase their raw materials from
economically developed countries. This can make supplies relatively che
country improves, strengthening its currency, the business may have to
worry rising the cost of sales and, most likely, the price they charge f

Non-financial

- **National crises:** disasters and states of emergency (e.g. war, disease, ea
catastrophic consequences for those affected. They can also significantly
to purchase supplies from the affected area. If a business does not have
they might lose all raw materials to make their goods/services. This wou
production, fewer sales, less profit and, ultimately, business failure.
- **Less export demand:** businesses value their key contracts because thes
quantities of goods. However, firms that rely mostly on consumers from
products/services could suffer in the long run.

A UK-based business that sells mostly to Turkey, for instance, could make a lot of
popular producer for the country. However, if the Turkish government decided to
within their own local economy, in order to keep the money in Turkey, the busine
main customers.

Business Burns Out
Some businesses will fail due to a number of different influences. A firm that loses its consumer base because of a drop in export demand, for instance, may also have been ignoring what the market wanted/needed.

Example:
Wax Stubs Inc. are a manufacturer of candles. The company is based in the USA and sell mostly to consumers in Spain. Once the 2008 financial crisis hit, Spain's government promoted that people should spend their money on Spanish companies in order to keep the money in the country. Wax Stubs Inc. lost the majority of their business from this as Spain was their biggest consumer. Nevertheless, Spanish consumers had been turning away from Wax Stubs Inc. by this point anyway because their candles were so expensive and produced with unethical raw materials. Wax Stubs Inc., therefore, could not blame only the 2008 financial crisis for their failure as they had not been listening to their market.

2.3.3. Questions

Please write your answers on a separate piece of paper or in an exercise book.

5. *Copy out and fill in the following table, using the phrases below. The first one ha*

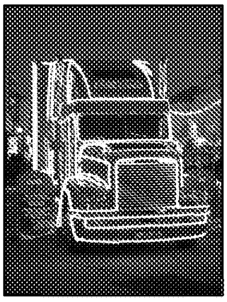
Currency strength   Planning   Communication

Economic recession   Efficiency   Marketing

Internal Causes of Business Failure	External Ca
	Currency strength

6. *Identify and explain c[illegible] that may come from a business ignoring the follo*
- ***a.*** *Wo[illegible] c[illegible]*
- ***b.*** *Ec[illegible] stability*
- ***c.*** *Ma[illegible]ing*

Focus: Coca-Cola



The Coca-Cola Co

The following table shows the profi
for The Coca-Cola Company at ye
and 2010. All figures are in million

Profit and Loss Account for The Coca-Cola Comp				
	2014		**2012**	
	Expenses	**Income**	**Expenses**	**Income**
Sales Revenue		8,264		8,062
Cost of Sales	5,391		5,162	
GROSS PROFIT				
Administrative expenses	1,668		1,671	
Other operating expenses	286		301	
OPERATING PROFIT				
Interest Paid	126		91	
NET PROFIT				

Questions:

a) Calculate the following three figures for 2014, 2012 and 2010:
   i) Gross profit
   ii) Operating profit
   iii) Net profit

b) Calculate the following three figures for 2014, 2012 and 2010:
   i) Gross profit margin
   ii) Operating profit margin
   iii) Net profit margin

c) Using the data from your calculations, analyse whether The Coca-Cola Co
increasing or decreasing and suggest how the company could improve it

2.3. Keywords

Gross profit:	The difference between revenue and cost of sales
Operating profit:	The difference between gross profit and other op
Net profit:	The profit left after deducting COS and all operati
Profitability:	How profitable a business is, comparing gross, op sales revenue
Cash:	Money available for payment of day-to-day activi
Profit:	Money that is left after all expenses and dividends
Fixed assets:	Things such as property and equipment that are o
Current assets:	Assets that a business owns for up to a year, such Assets are easier and quicker to convert into cash
Current liabilities:	Debts that a company has and that will be paid w
Long-term liabilities:	Debts that a company has and that will be paid ir
Net current assets:	Also known as *Working Capital*, this is the finance its day-to-day processes. It is calculated with the Liabilities
Net assets:	This is what is left once all liabilities have been su calculation for this is Fixed Assets + Net Current A
Liquidity:	The ability that a business has (through its assets)

2.3. Answers

1. **Sweet Things Ltd is a baker of cakes, tarts and biscuits. The compan ingredients and production supplies for the year 2014–15, while sa £135,000.**
   a. **Calculate the company's gross profit for 2014–15.**

$$Gross\ Profit = Revenue - COS$$

$$Gross\ Profit = 135{,}000 - 54{,}000$$

$$Gross\ Profit = £81{,}000$$

b. **Complete the following profit and loss account for Sweet Thing**

Profit and Loss Account for Sweet Things Ltd in 2014–15

	Expenses	**Income**
Sales Revenue (a.k.a. Turnover)		*£135,000*
Ingredients	*£13,000*	
Production supplies	*£6,000*	
Labour costs	*£35,000*	
Cost of Sales	***£54,000***	
GROSS PROFIT		***£81,000***
Business expenses	*£8,000*	
Administrative expenses	*£5,000*	
Total Other Operating Expenses	***£13,000***	
OPERATING PROFIT		***£68,000***
Interest Paid	*£2,650*	
NET PROFIT		***£65,350***

2. **The table below shows the incomings and outgoings for Sweet Thin**
   a. **Calculate the net cash flow of 2014–15.**

Incomings and Outgoings for Sweet Things Ltd 2014–15

	£
Cash received (Incoming)	*135,000*
Cash paid (Outgoing)	*54,100*
Net Cash Flow	***£80,900***

   b. **Identify two reasons why a company's net cash flow can differ f**
   Answers may include (but not limited to) debtors paying in the next t share issue and government grants.

3. **Sweet Things Ltd holds onto its products for five days. The firm give (supermarkets) 30 days to pay for their purchases while the compa the ingredients) expect to be paid in 15 days after any order.**
   a. **Calculate the working capital cycle for Sweet Things Ltd.**

Length of Working Capital Cycle
$= \textit{Time Goods Held} + \textit{Time Receivables Paid} - \textit{Trade C}$

$\textit{Length of Working Capital Cycle} = 5 + 30 -$

$\textit{Length of Working Capital Cycle} = 20$

   b. **Explain what the answer to 3.a. means.**
   This explains that it takes Sweet Things Ltd 20 days to convert its raw into cash.

4. **In this section, we talked mostly about profit and loss for Eagles Da during 2013–14.**

Statement of Financial Position for Where Eagles Dare Ltd

	2014–15 (£000s)	2013–14
FIXED ASSETS		
Factory	100	10
Office	65	65
Machinery	30	30
TOTAL FIXED ASSETS	195	19
CURRENT ASSETS		
Cash	[illegible]	20
Stock	20	60
Debtors	10	15
TOTAL CURRENT ASSETS	70	95
CURRENT LIABILITIES		
Overdraft	(5)	(7
Creditors	(30)	(25
TOTAL CURRENT LIABILITIES	(35)	(32
NET CURRENT ASSETS	35	63
LONG-TERM LIABILITIES (LTL)		
Bank loan	(75)	(95
Property lease	(20)	(20
TOTAL LTL	(95)	(11
NET ASSETS	**135**	**14**
EQUITY		
Owner investment	60	60
Retained profits	75	83
TOTAL EQUITY	**135**	**14**

a. **Calculate the current ratio for Where Eagles Dare Ltd during 2**

$$Current\ Ratio\ for\ 2013\text{–}14 = \frac{Current\ Asse}{Current\ Liabili}$$

$$Current\ Ratio\ for\ 2013\text{–}14 = \frac{95}{32}$$

$$Current\ Ratio\ for\ 2013\text{–}14 = 2.97\ (rounded\ to\ 2$$

b. **Calculate the acid test ratio for Where Eagles Dare Ltd during 2**

$$Acid\ Test\ Ratio\ for\ 2013\text{–}14 = \frac{Current\ Assets - In}{Current\ Liabil}$$

$$Acid\ Test\ Ratio\ for\ 2013\text{–}14 = \frac{95 - 60}{32}$$

$$Acid\ Test\ Ratio\ for\ 2013\text{–}14 = \frac{35}{32}$$

$$Acid\ Test\ Ratio\ for\ 2013\text{–}14 = 1.09\ (rounded\ to\ 2$$

c. **Explain the main difference between current ratio and acid tes**
Students should show understanding that acid test ratio takes into ac easily (and quickly) converted into cash. Due to this, inventory (i.e. sto

5. **Copy out and fill in the following table, using the phrases below. Th for you.**

Currency strength Planning Communication Nati
Economic recession Efficiency Marketing

Internal Causes of Business Failure	External Ca
Planning *Communication* *Innovation* *Efficiency* *Marketing*	*Currency strength* *National crisis* *Economic recession* *Export demand*

6. **Identi explain one effect that may come from a business igno**
   a. *Working capital. Possible effects may include:*
      - *The business might run low on cash/assets with which to pa*
      - *There may be too much cash which should have been investe therefore, overall profits*

   b. *Economic stability. Possible effects may include:*
      - *Loss of customers as disposable income decreases*
      - *If the business sells low-value goods, there may be a sudden been prepared, i.e. loss of potential earnings*

   c. *Marketing. Possible effects may include:*
      - *Fewer people learn about the business/brand. These people*
      - *Business has more cash available to invest in other areas*

2.4. Resource Managemen

2.4.1. Production, Productivity and Efficiency

! Key Points Covered

- Job, Batch, Flow and Cell Production
- Productivity
- Efficiency

Methods of Production

A business must choose the right method of production to fulfil demand for its go
that businesses choose depend on many factors, including the size/type of the ma
aims and growth objectives.

Job

This method of production is the one of choice for small businesses and sole trad
product at a time, such as an artist working on a piece of pottery.

Batch

Bakeries are the classic example of this production method. A bakery will focus on one type of bread, baking as many loaves as it can, before switching production to another and baking enough to meet demand. The method normally requires specific equipment (such as a baker's oven) but every good is produced in the same way. This is a much more efficient method than job production because manufacturers can produce many goods at a time. It is flexible, too, as the busines can produce goods to order as demand increases and decreases.

Flow

This method of production is used by car manufacturers, and other such business
a significantly large scale. Businesses manufacture their goods in a conveyor-belt
equipment. Once in motion, however, this method of production is extremely cos
method when they have a piece of equipment to dedicate to the manufacture of
focusing one factory on the production of their Fiesta cars.

Cell

Large manufacturing firms, such as producers of electronic goods, use this method as a way to efficiently divide production. Employees are split into teams, with each team working in the same way but focusing on a different product. This method increases the responsibility that employees have as opposed to flow production, where everyone has one or two tasks, working in more of a conveyor-belt style. Cell production works especially well for extremely large companies, who have so many employees that duties cannot be carried out without being divided.

Productivity

Production and productivity differ in a similar way to distance and speed, e.g. dista
was able to go while speed shows how quickly they were able to do it. Production
output a firm produces in a specific amount of time, while productivity gives the h
each input.

Outputs can include the amount of productivity per person, per factory or per ma
monitor their employees on how many sales they make. This productivity is meas
per salesperson.

Let's use an example:
A textile worker might be able to produce seven pairs of gloves in one hour, and s
their productivity would be seven gloves per hour. A machine producing the same
gloves may be able to do this more quickly, increasing the productivity to, say, 35
pairs of gloves per hour.

This example shows that machinery is able to achieve higher levels of productivity
than a human workforce. However, it is good to note that not all machinery can
perform tasks to the high-quality levels of human workers. Many consumers also
value handmade goods over their machined counterparts and will pay more for
the quality.

Factors that Influence Productivity

Businesses use all sorts of methods in order to increase their productivity, includin

- Increasing the number of hours that employees work
- Making changes to business processes
- Motivating the workforce
- Purchasing new equipment, technology and premises
- Increasing the amount of training that employees receive

There are downsides to these methods, however, which can lead to pushback fro

- Employees very rarely choose to work longer hours
- While a firm may offer new training or change business procedures, their to learn
- If a labour force is expected to increase its productivity, it may want to be
- Whenever a firm announces changes that affect productivity, some memb as a threat to their jobs

Productivity and Competitiveness

Both of these terms are closely linked with the success of a business. Firms lookin
competitiveness within a market (e.g. gain more market share) will explore produc
achieving this.

The operations department is normally the business area responsible for increasin
processes that operations lead must be in line with the aims and objectives of the
become more competitive, for instance, operations will need to support this by in

Firms concentrate on productivity as a method of becoming more competitive fo

- Firms that cannot produce enough to fulfil market demand will lose out to business must, therefore, increase productivity in order to meet demand a
- Markets that have particularly price-elastic demand are very competitive a to reduce their costs enough (e.g. by increasing productivity) so that they
- If a firm's main objective is to decrease its costs by 15 per cent, it can achi productivity. The more goods a firm can produce, the lower its overall c
- Service-focused firms concentrate on productivity as a way to provide The more goods or materials a business has available at any time, the more co demand and, hopefully, encourage further sales in future.

Efficiency

This refers to the maximum output a business can achieve through a minimum nu
Efficiency involves everything from a business's workforce to its procedures, scale,
equipment and machinery).

Efficiency can be improved either by a firm increasing the number of outputs it pr
producing its outputs using fewer inputs.

Let's show that visually:
Efficiency method 1:

Business's Inputs (i.e. labour, capital, etc.)	→	**More** Outputs (i.e. products, servi

Efficiency method 2:

Fewer Inputs (i.e. labour, capital, etc.)	→	Business's Outputs (i.e. products, servi

Labour-intensive or Capital-intensive Production?

Businesses make the decision whether to focus on labour- or capital-intensive skills and efficiencies ... with each factor of production. Is the business's lab machinery? ... it produce more at a lower cost if it invested in more equipmen size and position within the marketplace and the kind of service consumers need,

When a firm understands which route is best for it, it can explore the different op more efficient. These include:

- **Productivity of labour:** encouraging the workforce to increase their proc targets, motivation and/or better matching people's skills to tasks
- **Nature of processes:** businesses must use the correct method of produc manufacturer might use flow production since it needs to produce many standard
- **Capital utilisation:** the fixed costs of a business stay the same regardless so a business must utilise these (i.e. equipment, machinery) to their maxim goods/services will become more expensive to produce.
- **Scale:** businesses all look for profit and so they also look to grow. This ca as purchasing, which help a business lower costs overall. However, if a bu suffer from diseconomies of scale, such as poor communication through
- **Innovation:** firms are always looking for cost savers, ways to either produ efficiently or deliver them more cheaply. Retailers that move online, for in longer needing a shop window.
- **Lean production:** businesses invest in methods to reduce waste not only as a way to save money. Less waste (as well as fewer repeat processes) he and improve efficiency.

2.4.1. Questions

Please write your answers on a separate piece of paper or in an exercise book.

1. *Complete the following sentences using the phrases* flow, job, batch *and* cell.

   Car manufacturers, such as Toyota, are well-known examples of ______________ focus their machinery on the creation of the same product over and over again. on the other hand, uses ______________________ production because each pro bakery is the classic example of ______________________ production. Paint ma Technology firms like to use ______________________ production because it all on one specific task(s).

2. *Identify and explain two ways in which a firm can increase its efficiency.*

2.4.2. Capacity Utilisation

! ***Key Points Covered***

- Capacity Utilisation
- Over- and Under-utilisation of Capacity
- Improving Capacity Utilisation

Quantitative Skills Co
QS 2: calculate, use ar

Firms calculate capacity utilisation to show their actual output and how it compare output they could produce.

The equation for this is:

$$Capacity\ Utilisation = \frac{Current\ Output}{Maximum\ Possible\ Output} \times$$

Let's use an example:
Plastic People is a company that manufactures mannequins for fashion retaile three factories where it is able to produce a maximum of 50,000 mannequins per however, it has only managed to produce 37,000 mannequins each month.

$$Capacity\ Utilisation\ for\ Plastic\ People\ Ltd = \frac{Current\ Ou}{Maximum\ Possib}$$

$$Capacity\ Utilisation\ for\ Plastic\ People\ Ltd = \frac{37{,}000}{50{,}000}$$

$$Capacity\ Utilisation\ for\ Plastic\ People\ Ltd = 0.74 \times$$

$$\boldsymbol{Capacity\ Utilisation\ for\ Plastic\ People\ Ltd = 74\ p}$$

This calculation shows that Plastic People Ltd is performing at only *74 per cent of i*

Implications of Under- and Over-utilisation of Capacity

In the previous example for Plastic People Ltd, we showed that the business was u was not making the most of the machinery/workforce/equipment available to it. T over-utilisation, where a business runs at more than 100 per cent of its available ca

There are problems that come with under-utilisation of capacity, including:

- The fewer resources that are used by a firm, the higher the fixed costs are if fixed costs are spread across more products they will work out cheaper
- Firms that under-utilise their capacity run the risk of not meeting demand case, a firm would have *excess demand* that it is unable to fulfil. This could negative image for itself of a firm that is not strong enough to compete.
- The workforce of a firm that under-utilises its capacity could be lacking in to this

Over-utilisation of capacity comes with many issues, too, including:

- Workload can get too intense for a firm's workforce, who then become de
- Whenever machines or people do things quickly, they run the risk of shed be able to produce more goods in the given time, but each product may
- If a business is already producing at over-capacity, it will have problems if higher as the firm will have no way of fulfilling its surge in custom
- Maintenance of equipment and machinery becomes near-impossible sinc tilt at all times

Silver Linings
It is worth noting that there are positives that come from both over- and under-u
under-capacity, for instance, will have time available to do necessary maintenance
demand. Over-utilisation, on the other hand, will create maximum sales (if quality
profit, which can be reinvested into the business in order to purchase more capac
meet demand.

Improving Capacity Utilisation

As we now understand, fixed costs do not change and so businesses should alway
of the capacity they have available. This will help keep production costs low while
fulfil potential demand.

A firm can make improvements to its utilisation (wh... ir...easing or decreasing us

- **Estimate the long-term level...** ...this will help the business prepa demand so that it is alw... ...as close to the necessary capacity as
- **Create more d... ...** ...can be done through promotion and brand st If a ...ss ...pacity to produce 100,000 units, for example, but does wo... ...ate that demand.
- **Understanding the consumer:** this is normally done through primary an more a business learns about its customers (and potential customers), the to make sure it meets demand.
- **Sale of assets:** if the business is continually unable to use its entire capac wish to consider selling some of its machinery/equipment. This money co business as promotion in order to create more interest in its goods.
- **Employing more/fewer staff:** capacity can take the form of equipment, business has more employees than its consumer demand requires, it may Likewise, if demand is high, the business could need more staff in order to manufacture goods.

2.4.2. Questions

Please write your answers on a separate piece of paper or in an exercise book.

3. *Copy out the following statements into the correct categories.*

Statements
• *Quality might be ignored and so can decrease to the point of products be*
• *The fewer goods a firm produces, the higher the fixed costs per unit*
• *Maintenance of equipment becomes impossible as there is simply not eno*
• *Workforces lack in motivation as there is little drive to over-achieve*
• *Motivation of employees decreases because th... ...nt of work is too in*
• *Firms are unable to meet sudden spikes ...d...nd*

Drawba... ...-utilisation	Drawba

4. *A cutlery manufacturer produces between 250,000 and 300,000 sets of cutlery e goods, the firm uses three expensive pieces of machinery (which it owns) and en years, however, the demand for cutlery has fallen and so the firm has had to cu produces.*

a. *Identify whether the manufacturer is experiencing under- or over-utilisatio*

b. *Explain one way in which the firm could improve its utilisation of capacity.*

2.4.3. Stock Control

! *Key Points Covered*

- The Stock Control Diagram
- Buffer Stocks
- Implications of Poor Stock Control
- Just-in-time Ma
- Waste Minimisa
- Competitive Adv

The Stock Control Diagram

Stock involves the raw materials, supplies or goods that businesses hold over a sp must keep tabs on (i.e. *manage*) what stock they have, what they have sold/used a Without good stock management, most businesses would go out of commission w

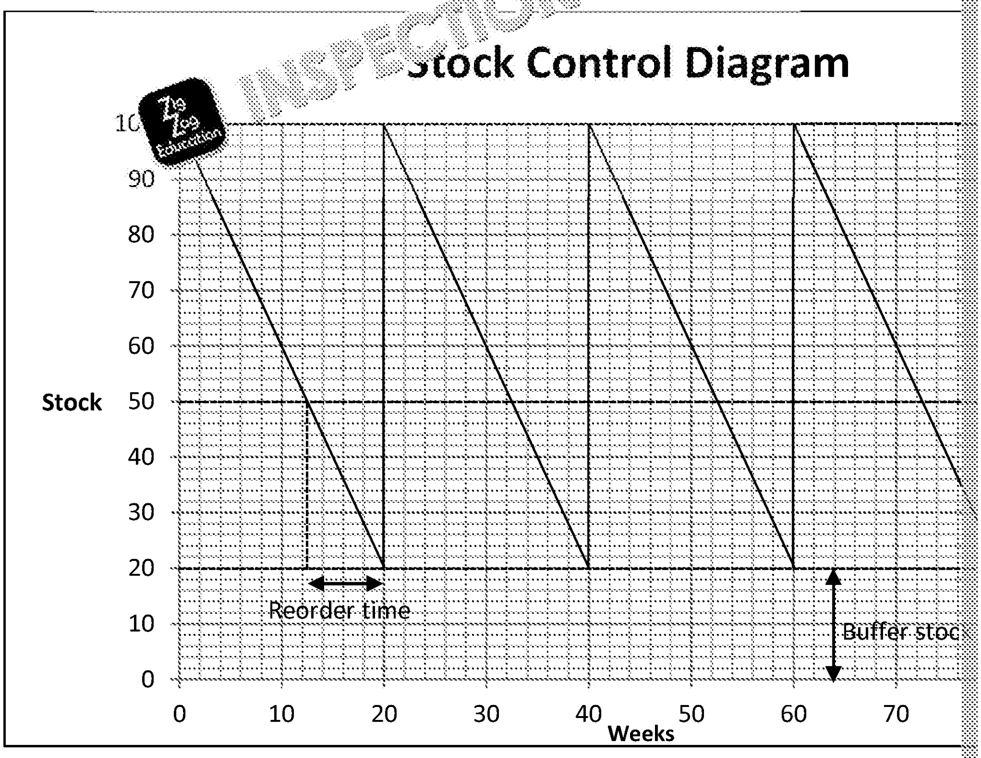


Diagram: Stock Control Diagram

The above is an example stock control diagram. This allows us to identify:

- The reorder level of stock
- The level of buffer stock available
- The time it takes for stock to arrive once ordered

The *buffer stock* shows the difference between the absolute minimum stock that a case, 20 units) and zero.

The *reorder level* shows how low the stock can get before the company needs t

The *reorder time* tells us how long it takes for new stock to arrive once the compa

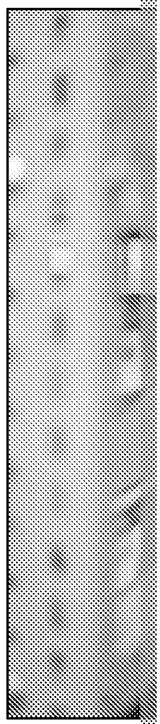
In the example above, new supplies take around seven weeks to arrive once order of stock once there are 50 units left. The stock arrives by the time the company ge

Buffer Stocks

The buffer stock of a business is the difference between the minimum amount of s hold and absolute zero. For example, if the minimum number of brushes a paintb 150 this is also the business's buffer stock.

There are positive and negative sides to holding buffer stock, which differ from co

Advantages of holding buffer stock:



- **Production flow:** large manufacturing firms, such as Toyota cars, need to keep a steady flow of production. If stock falls below a certain point (or even down to zero), the business will hit a bottleneck, which will slow production to a halt. Keeping a steady flow of stock, therefore, helps production flow, too.
- **Ability to satisfy demand:** having buffer stock readily available ensures that businesses are always able to fulfil normal demand. Supermarkets, for instance, keep a steady flow of stock (pints of milk or bags of potatoes) because they know there will be demand.
- ***Coping with peaks in demand:*** this is important for most businesses, especially those whose demands are influenced by cultural trends. Take a shoe shop, for instance: if the owners learn that their shoes have received a surge in popularity (perhaps a famous singer was seen wearing them), they will need to react by buying in more stock so that they can satisfy the sudden spike in demand.
- **Economies of scale:** buying in bulk helps businesses bring down their cost of sales because they have more power to negotiate with suppliers. An electronics company, for instance, might be able to purchase raw materials more cheaply if they place a significantly high order with their supplier.

Disadvantages of holding buffer stock:

- **Opportunity costs:** one main problem for any business is the fact that th could have been better used as reinvestment in the company. It is a risk fo
- **Costs of storage:** this can involve stocking warehouses full of finished pr firms), filling shelves and freezers (as with supermarkets) or even keeping shops or convenience stores). Stock might need to be chilled, heated or fr form of management, such as a computerised database. All of these aspe
- **Depreciation/obsolescence:** let's use the shoe shop example again. If a f popular, management may respond by purchasing the item in bulk. Howe enough of these shoes while they are at their peak in popularity, the shop are worth nothing compared to what management originally paid for the supermarkets for whom the majority of goods have sell-by dates, and so right time.
- **Security:** stock needs to be taken care of; this is not just to keep it refrige not damaged or stolen. Therefore, companies go to great lengths to mind systems such as CCTV.
- **Insurance:** in case any stock is stolen or damaged, businesses need some insurance for this, which can be very expensive, especially if the goods are
- **Administration:** buffer stock is handy for fulfilling demand, but the busin order it, transport it and check it is up to the correct standard. This all cos

Implications of Poor Stock Control

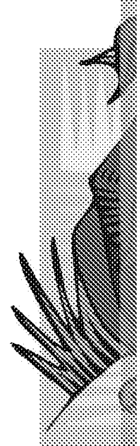
Firms that have too much stock (i.e. much more than demand) are running ineffici money that could be better used as investment in the business. Likewise, not havi significant risk: if businesses have insufficient stock levels, they will make a loss on are unable to satisfy.

These are known as *stock-in* and *stock-out* costs, i.e. the costs of holding too much enough (stock-out).

Let's use some examples:

A large electronics retailer has been at the forefront of consumer technologies for new computer or DVD player, they go there first. The retailer has ignored the lates that it is a fad that will die very soon. However, the fad has not died – in fact, it c business has now lost sales to its competitors who purchased lots of new stock. Th costs in this instance, having insufficient stock to meet demand.

If the business had been correct, then their competitors would have been left with lots of stock that they could not shift. This would have meant significant stock-in costs for the business's rivals.



Christmas time is normally a good period for butcher shops, with turkeys their biggest seller of the season. It wasn't always a good time for one small shop, though, who would purchase enough birds to satisfy demand but never sell them all. One year, in fact, they bought 100 birds and only sold 25. The other 75 birds could barely be sold, especially after the Christmas period, and so the business suffered significant stock-in costs. The shop have since learned from their mistakes and now take orders for turkeys at Christmas. Customers must pay for each turkey in advance and collect one week before Christmas. This ensures that the business purchases only enough birds to satisfy demand – no more, no less – which makes the Christmas period a happy

Just-in-time Management of Stock

The just-in-time (JIT) method of managing stock has become more adopted over method keep a low inventory of stock and produce only to specific orders. This m forecasting method, wherein businesses predict how much demand there will be a to cover this; instead, businesses produce to requirements. This method requires a must be able to inform their suppliers in time when consumer demand rises.

Advantages of JIT Management of Stock

- **Time saver:** businesses receive an order, request the stock from their sup good or put it directly on the shelves. There is no need to keep stock in st
- **Money saver:** the business will spend less money on stock until they a
- **Compact production:** with less stock in storage, a company's production hopefully more efficient as a result
- **Added value:** a business can instantly add value to its stock because it is eit shop shelves or manufactured/converted into a good. There is very little t which would be money wrapped up in stock.
- **Less obsolescence:** this is still a risk, but businesses run much less risk of and sell goods when there is demand
- **Less risk to goods:** if fewer goods are in storage, then they are less likely

Disadvantages of JIT Management of Stock

- **Suppliers:** businesses need suppliers they can trust to do a good job at s produce stock in time, the business will suffer greatly.
- **Expensive:** this can be expensive to do on a grand scale, as businesses ne computer systems in order to monitor incoming orders and available stoc
- **Mass orders:** if a business using JIT stock management suddenly receives to cope with the volume of requests. Moreover, the business's suppliers m enough stock.
- **Unforeseen circumstances:** war, famine and natural disasters can put ha business's supplier

The JIT method of stock control is particularly suited to businesses such as car ma print on demand. In both of these cases, stock is only [illegible] once an order has closely linked with *waste management* and *lean production* since it helps a busines and improve efficiency from start to finish.

Waste Minimisation

Businesses [illegible] the amount of waste they create for many reasons, from addre reacting to customer demand. By correctly managing their waste, businesses can simultaneously bringing down their costs of production.

Technology has been a major player in the movement towards waste minimisatio these new technologies in order to:

- Reduce defective products
- Curb overproduction of goods
- Decrease wait time for consumers and downtime of machinery
- Monitor and moderate unnecessary stock
- Streamline production

Waste minimisation also relates to actual waste, i.e. overuse of product packaging bring down their packaging costs by using reusable boxes. Transport costs, mean their goods in bulk rather than per order.

Competitive Advantage from Lean Production

Lean production is a form of production that focuses on waste-saving measures, i manufacturers. This form of production involves a range of techniques, including:

- JIT
- Total quality management (TQM)
- Kaizen
- Cell production
- Reduction of excess stockholding
- Improvement of communications between production and marketing dep

Further Reading:
Jump to the chapter on *quality management* to learn more about *TQM* and *ka*

Benefits of Lean Production

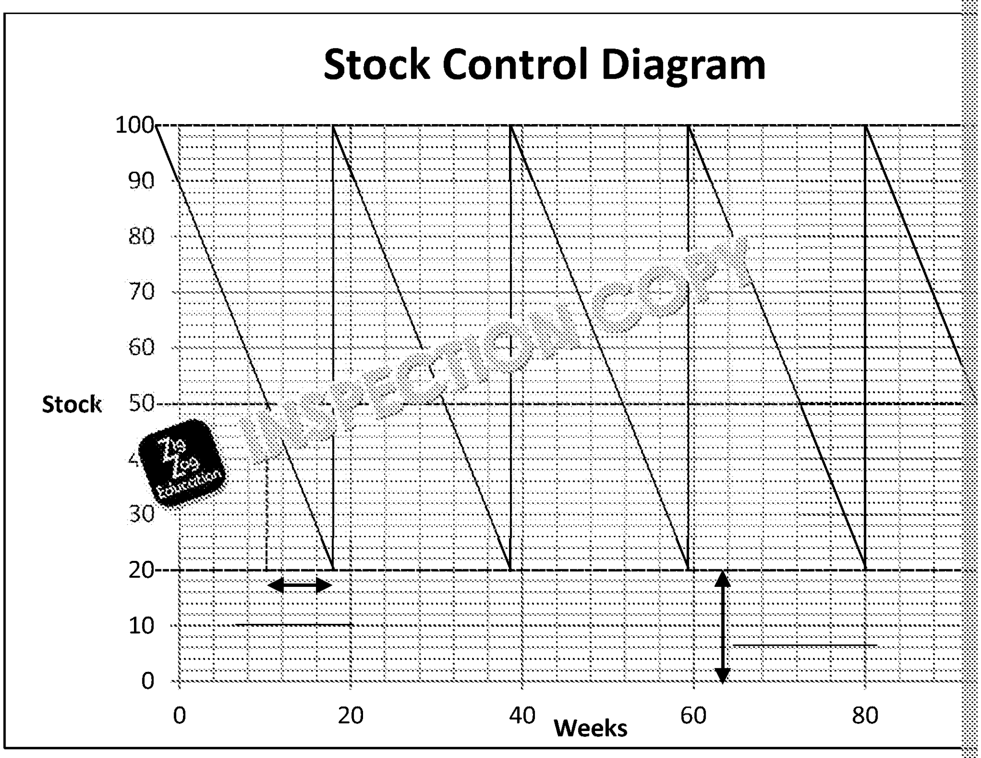
Businesses can reap many rewards from employing lean production, including:

- **Productivity:** this increases as employees decide the most efficient way t
- **Motivation:** businesses can motivate their workforces by giving more res
- **Shared decisions:** empowered workforces take part in decision-making, w management and opens up the potential pool of ideas
- **Waste management:** businesses that operate lean production benefit fro holding (from JIT methods), which increases available funds and, therefor
- **Quality:** employees and management work together to streamline and in can help increase quality

2.4.3. Questions

Please write your answers on a separate piece of paper or in an exercise book.

5. *Copy out the following stock control diagram and fill in the five missing labels.*



6. *Identify and explain two reasons why companies hold buffer stocks.*

2.4.4. Quality Management

! Key Points Covered

- Quality Assurance, Control and Circles and Total
- Quality Management
- Continuous Improv
- Competitive Advan

The quality management techniques used by businesses relate closely to those of

Quality Assurance vs Quality Control

These two terms are frequently used in business and are often confused. Let's set
quality assurance and what is *quality control*.

	Quality Control (QC)	
Description	Analysis of quality in a finished good/service.	Analysis that are goods/s
Why used?	QC is a corrective method. It helps identify and fix defects in goods before they are released.	QA is a improve producti
When used?	This is a reactive measure. Businesses make improvements to any defects at the end of the production process.	This is a forecast in place occurrin

Quality Circles: One way for businesses to empower their workforces is to use *qu*
of their employees into groups (quality circles) and give them direct responsibility
helping to improve – business processes. The circles identify potential for enhance
and efficiency.

Kaizen

Kaizen businesses work to improve their processes with the idea that this should e
outcomes. Unlike quality circles, which give responsibility to some employees, kai
of the workforce by continually asking for ideas on how employees believe their b

The kaizen method (also known as *continuous improvement*) can bring about man
employee motivation and productivity, reduction in wasteful processes, higher qu
a business's final products/services. Firms that use kaizen consider it an integral p
good example of kaizen-focused business is the Japanese car manufacturer Toyot

Did You Know?
The word 'kaizen' is Japanese for 'improvement'.

The philosophy behind kaizen is based on *gradual change* and *employee suggestio*
small, considered steps (rather than focusing on large, individual innovations) with
volume of changes will eventually result in huge improvement.

Businesses cultivate a *culture* of continuous improvement by encouraging their wo
These suggestions can be as big or small as necessary – sometimes improving the
creates the most noticeable of results! Suggestions can be given anonymously, us
person. Kaizen businesses focus on the talents of their employees, and their ability
than invest in expensive machinery in order to get to the same outcome.

Kaizen may seem like a long-winded (and, therefore, pricey) way of working, but b
(the people most involved in a business's quality procedures day in and day out),
foundation for innovation that gives them a competitive advantage over any rivals
quality, but increases motivation, too, as employees feel more valued and are, the
extra mile for their employers.

Total Quality Management (TQM)

TQM is another method that aims to empower employees: unlike kaizen, which w
involves the entire business; it is the culture of the organisation. Employees act lik
analysing the work they receive from other departments in order to, as a unit, criti
best quality product/service possible.

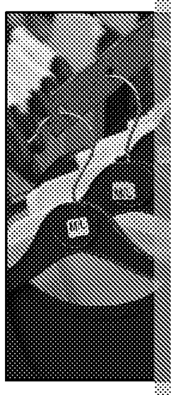
Competitive Advantage of Quality Management

Keeping goods/services to a high standard of quality, i.e. how well the product do
gives a business competitive advantage over its rivals – the higher quality your go
appears to consumers. This high-quality image can also give the perception that th
are of a similar value, leading to repeat purchases and word-of-mouth sales. In m
value high-quality products/services are more willing to pay high prices and so, if y
quality, higher consumers may be more likely to purchase from you.

The Competitive Advantage of Low Quality

Quality is an integral element to the success of many businesses. It allows firms to charge high prices and, therefore, earn high profits. Consumers often see high prices and associate them with high quality and so the companies continue to benefit from product sales. The element of selling price is not integral to all businesses, however.

The fashion retailer ZARA is a good example of a business that sells items at low prices while still achieving significant global success. The firm concentrates on imitating designer fashions, and does this both quickly and cheaply. ZARA's customers do not demand the highest quality possible. Rather, they are looking for fashionable items, which ZARA sells in the thousands. The firm produces its products at an efficient rate and so can easily react to sudden trends. In this sense, ZARA's business model is low selling price, but extremely high sales.



2.4.4. Questions

Please write your answers on a separate piece of paper or in an exercise book.

7. *Identify two differences between quality control and quality assurance.*

8. *A com[illegible] manufacturer is considering whether to employ the kaizen method i*
which k[illegible] would benefit the company.

Focus: BMW

Questions:

a) Assuming that the maximum capacity for Rover in 1999 was 100,000 units and that the maximum capacity for BMW in 2007 was 250,000 units, calculate the capacity utilisation for both.

b) Identify and explain two ways Rover could have improved its capacity utilisation.

c) Compare the benefits and drawbacks of BMW investing so much money in its Oxford plant.

d) BMW uses TQM in all its business processes. Analyse the potential value that the company can draw from this practice.

German Car Giant Shows B

The new Mini was launched in 20[illegible] car manufacturer Rover, the car is [illegible] BMW.

The German brand is known for [illegible] capacity and this takeover was no [illegible] produced 56,000 cars using 3,500 e[illegible] tripled this figure in 2007, employi[illegible] producing [illegible] cars.

Since BMW took over Mini, the co[illegible] the cars were manufactured, i[illegible] process, implementing high-qua[illegible] developing strong communications [illegible] making work schedules more flexib[illegible]

BMW also invested £230m into its O[illegible] further £100m in 2005. The com[illegible] robotic machinery throughout that [illegible] processes in the correct order. T[illegible] Quality Management (TQM) in BMW [illegible] role for any employee is to monitor [illegible]

h[illegible]
/mini-case-study-b[illegible]

2.4. Keywords

Job production:	When a business produces goods/services one at
Batch production:	When a business produces goods/services in grou
Flow production:	A constant flow where a production line focuses o
Cell production:	When a business splits itself into specialist areas, production of a good/service
Over-utilisation of capacity:	When a business produces more goods/services t This can cause stress on overworked staff and mi downtime and maintenance of equipment.
Under-utilisation of capacity:	When a business produces fewer goods/services t lead to staff being underworked, which may dem money on employees they do not need.
Productivity:	A company's hourly rate of output per each input
Efficiency:	How much a business can achieve through a mini costs
Kaizen:	Employees are organised into groups (quality circ for continuously analysing, and improving, the pr
TQM:	A constant, company-wide culture of quality man

2.4. Answers

1. **Complete the following sentences using the phrases *flow*, *job*, *batch***
   Car manufacturers, such as Toyota, are well-known examples of _FLOW_ *p*
   machinery on the creation of the same product over and over again. An ind
   the other hand, uses __JOB__ *production because each product is made indi*
   classic example of __BATCH__ *production. Paint manufacturers also use th*
   to use __CELL__ *production because it allows each group of workers to foc*

2. **Identify and explain two ways in which a firm can increase its effici**
   Answers may include, but not limited to: productivity (i.e. encourage incre
   through targets and reward schemes), inputs vs out... (i.e. fewer inputs f
   same amount of inputs for more output), inn... (i.e. creating better qu
   efficient ways of producing them) a... production (i.e. creating less w

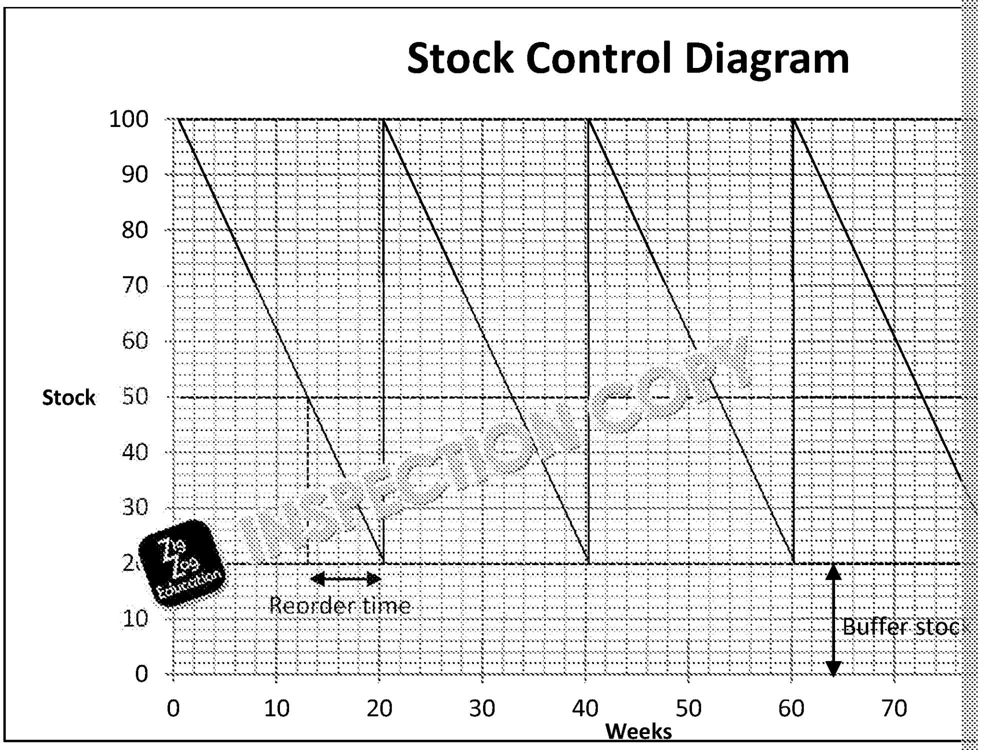
3. **Copy out the follo... ...ments into the correct categories.**

...w...cks of under-utilisation	Drawbac
The fe... goods a firm produces, the higher the fixed costs per unit *Workforces lack in motivation as there is little drive to overachieve*	*Quality might be ig the point of produc* *Maintenance of equ there is simply not e* *Motivation of empl amount of work is t* *Firms are unable tc*

4. **A cutlery manufacturer produces between 250,000 and 300,000 se produce this many goods, the firm uses three expensive pieces of m employs a workforce of 200. In recent years, however, the demand the firm has had to cut back on the number of goods it produces.**
   a. **Identify whether the manufacturer is experiencing under- or o**
      Students should show that the manufacturer is experiencing under-ut

   b. **Explain one way in which the firm could improve its utilisation**
      Ways to improve under-utilisation of capacity might include:
      - *Sales forecasts could help the firm predict any further drops*
      - *Create more demand through advertising, branding and pro*
      - *Market research to find out where the firm might be going w*
      - *Sell off one of the pieces of equipment to free up some cash f the firm*
      - *The firm may have to make redundancies if there simply isn'*

5. **Copy out the following stock control diagram and fill in the five mis**



6. **Identify and explain two reasons why companies hold buffer stocks**
   Students might include any of the following:
   - *Buffer stocks keep a company's production flowing, lessening the*
   - *A steady flow of stock also means firms can always fulfil their de*
   - *Keeping more stock than enough allows a firm to react to spikes*
   - *Bulk-buying of stock can lead to economies of scale through a red*

7. **Identify two differences between quality control and quality assura**
   Quality assurance is a proactive measure that involves managerial decisio implement processes that best ensure their goods are produced to the high

   Quality control, on the other hand, is a reactive measure. It involves the co products before they are made available on the market.

8. **A computer manufacturer is considering whether to employ the ka Explain one way in which kaizen could benefit the company.**
   Students could explain any of the following:
   - *Increase in employee responsibility can lead to motivation*
   - *Employees are the ones who know their processes best and so the increase in efficiency and productivity*
   - *This also relates to reducing wasteful processes, higher quality improvements in the business's final products.*

2.5. External Influences

2.5.1. Economic Influences

! ***Key Points Covered***

- The Effects of External Influences on Businesses
- The Effect of Economic Uncertainty on the Business Environment

Quantitative Skills Co
QS 4: interpret index n

There are many economic factors that can influence the success of a business.

Inflation
This describes the increase in general prices in an economy. Inflation is measured
(CPI), which considers the average consumer's shopping basket of goods and serv

An inflated economy has a few benefits to businesses, such as:

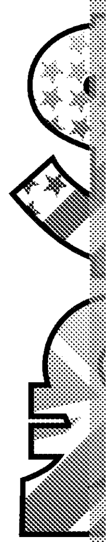
- It helps with borrowing as long as the available interest rate is less than th
- It raises the value of property and stock, which increases a business's capi
- It can allows businesses to increase their prices without raising suspicion f

However, an inflated economy poses a lot more negatives to a business than it do

- As inflation increases, so do prices, which can turn away consumers, espec essential goods
- Consumers can become price-sensitive and so look elsewhere once there
- Cash flow becomes much more difficult to come by
- Suppliers increase their prices, which puts more pressure on businesses to
- Company workers may demand more pay in line with inflation
- The country becomes less competitive as the currency means less
- Forecasting becomes difficult since there are so many changes happening

With all of these examples, the degree of severity for a business depends on how
If a business offers a particularly price-elastic good, it is very likely that consumer
once inflation sets in.

Exchange Rates
These show the price of one country's currency compared to another. In the UK, we compare all currencies to the pound sterling. For example, we might compare the US dollar 1.50 to the pound.



Appreciation describes the increase in value of a currency (against another) while *depreciation* tells us the opposite.

Appreciation creates a stronger currency, which can affect a business in many ways, including:

- Increasing the price at which businesses can sell their products abroad
- Decreasing the price of imports

As the price of exported goods increases, businesses may find it harder to sell the
harm revenue and, therefore, profits. If businesses sell products that have high pri
less competitive as demand decreases due to high prices.

Depreciation creates a weaker currency, which can affect a business in the opposit
given above.

Interest Rates
These are the costs of borrowing and rewards for lending. Businesses will generall
see that the return will be greater than the interest rates they would have to pay.

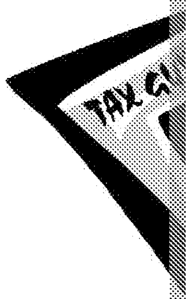
If interest rates fall, businesses can be affected in the following ways:

- **Less saving:** consumers do not want to save when interest rates are low a with businesses
- **Credit:** the cost of buying goods on credit decreases and so consumers c
- **Loans/mortgages:** the rates for these decrease, which gives consumers m with companies
- **Fewer costs:** a business's fixed costs decrease since interest rates are low

If interest rates rise, the opposite would occur with all of these examples. The effe still depends on the type of business. A firm whose product is not very price elasti affected as much as a firm whose product is extremely price elastic.

Taxation and Government Spending
Tax comes in two forms for businesses:

- Direct tax
- Indirect tax



Direct tax is that which is directly felt by the business, such as corporation tax. *Indirect tax*, meanwhile, covers such taxations as value-added tax (VAT) and excise duty (for alcohol, petrol and cigarettes).

Businesses can feel the effects of **taxation** in many ways:

- VAT increases/decreases the price of goods, which in turn increases/decreases demand and the volume of goods a business can afford to produce. Levels of production then inform businesses on decisions regarding redundancies, i.e. if there is not enough demand, there is not e employ workers
- High corporation tax can scare off new start-ups while low corporation ta to enter the market
- Excise duty can either help or hinder a business – firms selling alcoholic b difficult to compete with such high taxes to pay
- Low rates of income tax can give consumers more disposable income, wh
- Some taxes are set so that higher-earning businesses pay more than thos cash back into the economy, which helps less profitable businesses, while make a significant profit.

Government spending can significantly affect businesses, too:

- **An increase in government spending** can create jobs for skilled busines are required to build, for example, schools
- The new schools will require teachers, who earn money and spend with c
- Suppliers of raw materials also get paid for the building work to take plac
- Government spending can also encourage competition between business hurt others

- **A decrease in government spending**, on the other hand, can lead to a d businesses as there is less incentive
- Productivity would then decrease, leading to less competition between bu rates of unemployment
- With unemployment, of course, comes less consumer spending, which dir more susceptible to income elasticity of demand

The Business Cycle

This shows the ups and downs of an economy by following the growth of gross d main elements to any business cycle are *boom*, *recession*, *slump* and *recovery*.

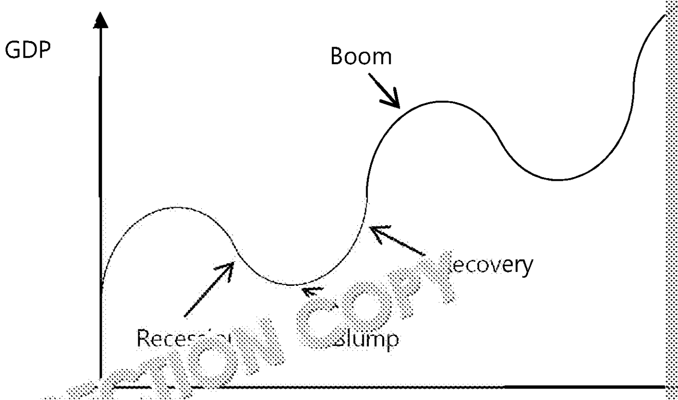


Diagram: Example of a Business Cycle

The business cycle has effect on a business depending on the income elasticity of products/services. A car manufacturer, for instance, may be greatly affected depe economy reaches in the business cycle. When consumers have less disposable inc as many luxury items, such as new cars. A regular baker, on the other hand, who p bread, would have fewer problems depending on the business cycle because the have money available to spend on bread.

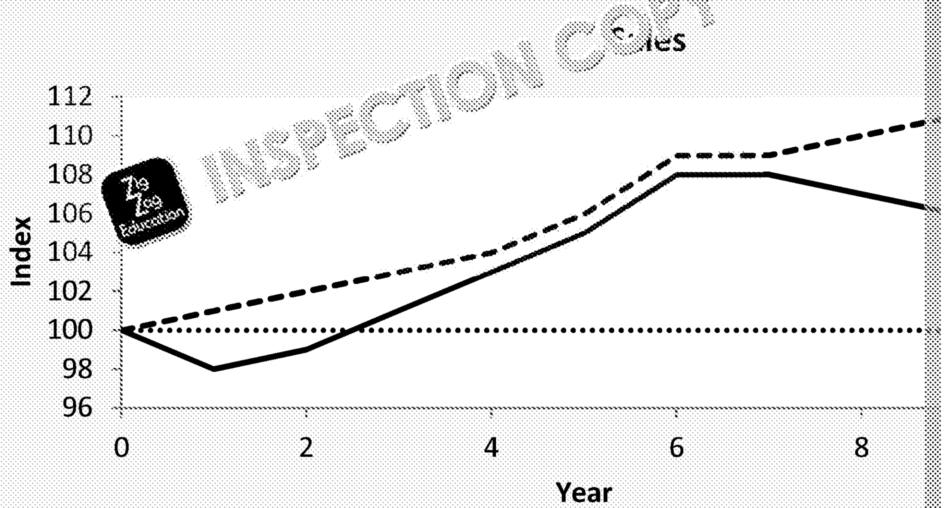
Interpreting an Index

In business it's often useful to make comparisons over time. One of the best ways **index**. The key idea is that all subsequent data points can be compared back to a shown with an index of 100 – it's 100 per cent of its value – then following data p

Index numbers are often used to show changes in stock market prices (such as th the price level (inflation).

Suppose we have sales figures for a firm in index form. An index of 104 tells us th compared to the base year. Index numbers can be below 100 if the value has dec compared to the base year then the index will be 97. Index numbers do not have when talking about an index for sales for example!

It might help to look at a visual example of index numbers. Below there is a line g different companies – Firm 1 and Firm 2 – in index form.



Note how the sales for each firm start at 100 at the base year, year 0. This does no same volume of sales. Instead it just shows 100% of their respective starting value changes in sales relative to the starting point.

We can see that sales for Firm 2 generally increase over time. The sales for Firm 1, to the base year before increasing.

The Effect of Economic Uncertainty on the Business Enviro

Nothing is ever certain in the business world, with economic environments changi refer to *macroeconomics* (factors affecting businesses that are beyond their contro (factors affecting businesses that are within their control).

Many of the world's leading businesses are dependent on their supply and so they times of economic uncertainty.

Let's use coffee as an example:

- If the world supply of coffee halved, supply would decrease
- Lower supply would turn the bean into an extremely precious commodity
- Suppliers would then be able to charge more for their beans
- Businesses would be forced to increase their costs
- Selling prices would then rise due to higher costs

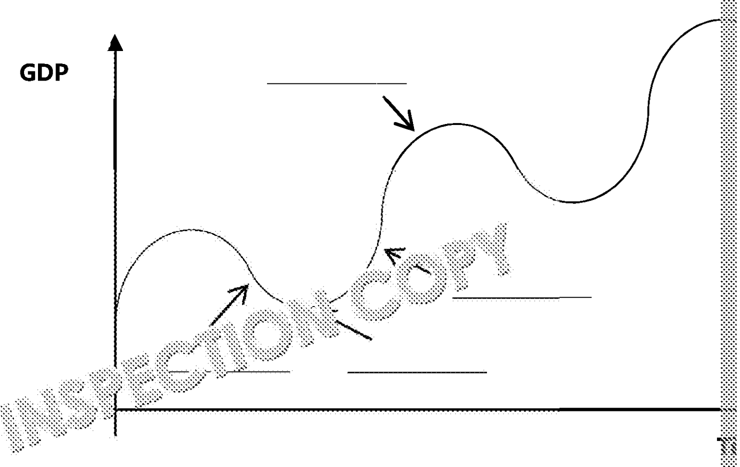
Businesses create *contingency plans* in order to manage economic problems such as a drop in world supply. These plans set out what to do in an emergency situation. Firms, therefore, need to *forecast* what economic problems are likely to occur, e.g. sudden fluctuation in an exchange rate, so that they can consider the best possible options.

Forecasting, however, is difficult, especially when it comes to uncertainty, and so m *preventative* measures that will help lessen the effects of economic factors. Many materials from more than one supplier – this way, if supplies dry up from one sou more it can use. Another preventative measure is the use of future contracts, whic currency in advance at a fixed rate. This helps prevent exchange issues later down expensive, especially if the exchange rate moves in the opposite direction to what

2.5.1. Questions

Please write your answers on a separate piece of paper or in an exercise book.

1. *The following diagram shows an example of a business cycle.*
   a. *Complete the diagram using the terms* boom, slump, recession *and* recove



   b. *Identify one characteristic of each stage in the business cycle.*

2. *Complete the following table to show either benefits or drawbacks to businesse*

Effects to businesses from an inflated econom
• *Businesses can increase their prices without raising suspicion* • *Consumers may become price-sensitive* • *Business cash flow becomes much tighter* • *It raises the value of property and stock* • *Suppliers are able to increase their prices* • *Company workers make demands for higher pay*

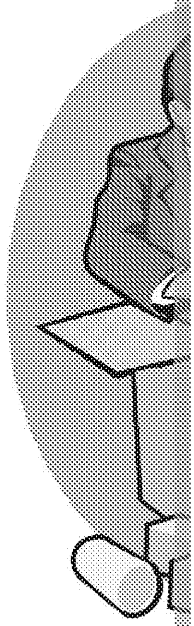
Benefits	D

Competition Policy

This is regulation to ensure businesses are competing fairly in the marketplace. It
monopolies and cartels. An example piece of legislation is the Fair Trading Act of
investigate business takeovers and scrutinises existing monopolies and anti-comp

Possible effects for businesses include:

- Lowering prices in order to compete, which brings down profits
- Improved quality
- Fairer competition
- Easier market entry for small businesses, who would otherwise have great difficulty getting a foot in the door
- Punishment (i.e. fines) for anti-competitive behaviour such as collusion and price-fixing



Health and Safety

This aims to ensure businesses provide safe working environments for their employees. An example piece of legislation is *Health and Safety at Work Act of 1974*, which states employers must provide an environment that safeguards the health, safety and welfare of all employees.

Possible effects for businesses include:

- Costs from complying with the legislation
- Enhanced company brand since it promotes a safe working environment
- Increased employee motivation

2.5.2. Questions

Please write your answers on a separate piece of paper or in an exercise book.

3. *The following shows a list of possible business effects and government legislatio correct effect.*

Motivation increases as working conditions increase	E
Enhanced company brand since it promotes a good working environment	
Improved quality of products/services	
Positive branding for any business that significantly reduces its harmful emissions	
Lowering prices in order to compete, which brings down profits	

4. *A paper manufacturer is looking into ways that it can comply with environment costs that come with this. Explain two ways in which the business can benefit fr environmental policy.*

2.5.3. The Competitive Environment

! Key Points Covered

- Competition
- The Market

Competition

Whenever two or more businesses go after the same consumers, they are said to another. This can happen in a *direct* way (e.g. two barber shops working in the sar streaming service vs a high-street cinema). Both forms of competition affect busin

Competition is generally seen as a positive thing: firms compete on low prices (wh quality can become higher (especially if this is the main competitive area) and cus makes consumers make repeat purchases).

There can be negative effects to competition, though:

- If price is the main focus of competition, companies may end up sacrificin expectations
- Some businesses will eventually fail (normally the smaller ones with less b unemployment and harm to the local economy
- As businesses grow competitively, they have the chance to consume smal competitive market

Imagine:
A convenience store has existed on the local high street for 50 years. The store sells everything from toilet paper and magazines to dog food and confectionery. The store sells a small selection of vegetables, too, but most vegetable selling is done by the local greengrocers down the street. Recently, one of the big supermarket chains has moved in by opening its own convenience store. This new store sells everything from toilet paper to dog food – even most vegetables – and so pulls in a lot of customers. The convenience store feels the pinch of this through a rapid decrease in customers, as does the greengrocers. Both stores have a choice: they can either try to compete or give up.

Competition affects a business's actions in terms of what products/services it sells greengrocer and convenience store would have to change if they wanted to stay a moved in. One way to do this would be to offer something the supermarket does local produce over the international options that supermarkets generally sell, this businesses to differentiate. Rather than selling the same things as a supermarket (bulk and, therefore, much more cheaply) the greengrocer and convenience store practices to local, independent produce.

The Market

The greengrocer and convenience store represent one way in which the competiti businesses. There are many more, however, such as:

- **Market size:** if there are few consumers, the potential for profit is not gre market has much potential for sales and, therefore, profit
- **Market price:** many organisations will alter their prices depending on the
- **Market expectations:** consumers become accustomed to how products how they are marketed. It is expected, for example, that most book deale instead of) from a bricks-and-mortar shop window

There are four main characteristics of a market, notably *perfect competition*, *mono*
monopoly. When a business is considering whether to enter a market, it must und
market and, therefore, what it can expect. Businesses use many methods to analys
Porter's *Five Forces* model:

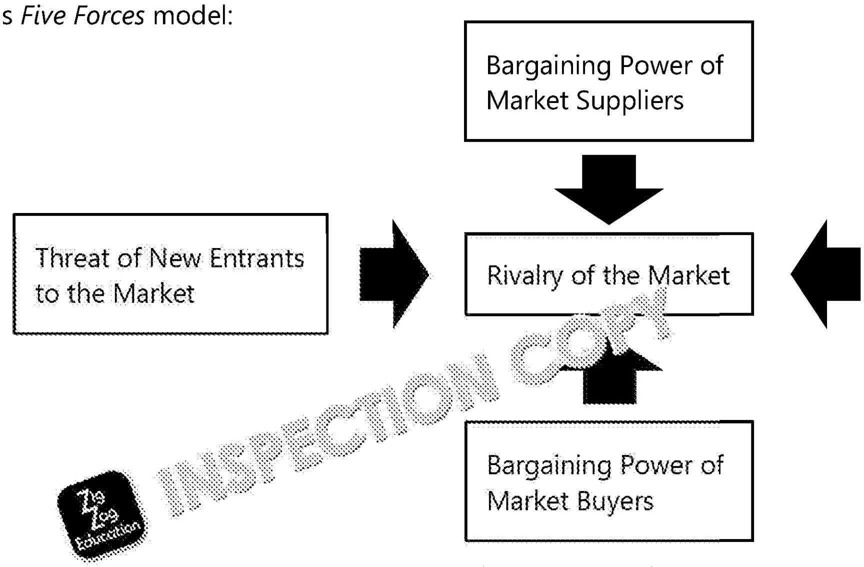


Diagram: Porter's Five Forces

Porter's model shows how the activities of a market are influenced by its key playe
businesses. We discuss Porter's Five Forces model in more detail in Theme 3 of Ed
well, though, as it gives a visual idea of the market place.

Analysing the market is especially helpful when considering whether to introduce
Motors, for instance, finally brought the battery-powered car to the masses after y
similar feats but without addressing the important aspects of price (must be affor
petrol-driven car) and convenience (how easy it is to refuel). Since its inception, Te
vehicles, including the Model S whose computer software can be updated over th
smartphones receive updates.

2.5.3. Questions

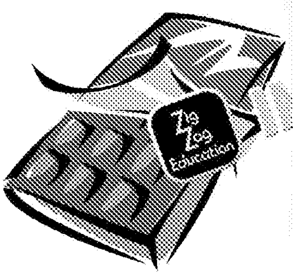
Please write your answers on a separate piece of paper or in an exercise book.

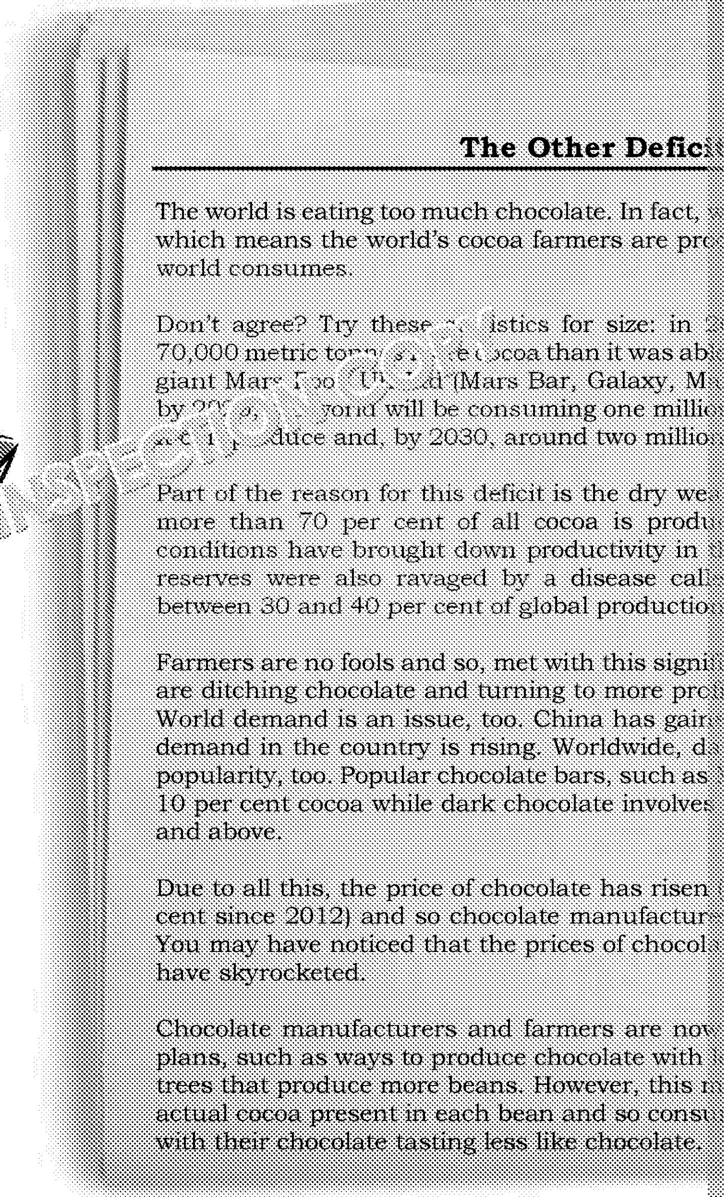
5. *Explain why the following two market elements are important to a company wh introduce a new product/service:*
   a. *Market price*
   b. *Size of the market*

6. *Explain two ways in which consumers might suffer from increased competition b*

Focus: Chocolate

Question:
Consider the world demand for chocolate and evaluate the effects that contingency plans may have on chocolate-product manufacturers.





The Other Defic

The world is eating too much chocolate. In fact, which means the world's cocoa farmers are pro world consumes.

Don't agree? Try these [illegible]istics for size: in 70,000 metric to[illegible]e cocoa than it was ab giant Mar[illegible] (Mars Bar, Galaxy, M by 20[illegible], [illegible] world will be consuming one millio [illegible]duce and, by 2030, around two millio

Part of the reason for this deficit is the dry we more than 70 per cent of all cocoa is produ conditions have brought down productivity in reserves were also ravaged by a disease cal between 30 and 40 per cent of global productio

Farmers are no fools and so, met with this signi are ditching chocolate and turning to more pro World demand is an issue, too. China has gain demand in the country is rising. Worldwide, d popularity, too. Popular chocolate bars, such as 10 per cent cocoa while dark chocolate involves and above.

Due to all this, the price of chocolate has risen cent since 2012) and so chocolate manufactur You may have noticed that the prices of chocol have skyrocketed.

Chocolate manufacturers and farmers are nov plans, such as ways to produce chocolate with trees that produce more beans. However, this m actual cocoa present in each bean and so consu with their chocolate tasting less like chocolate.

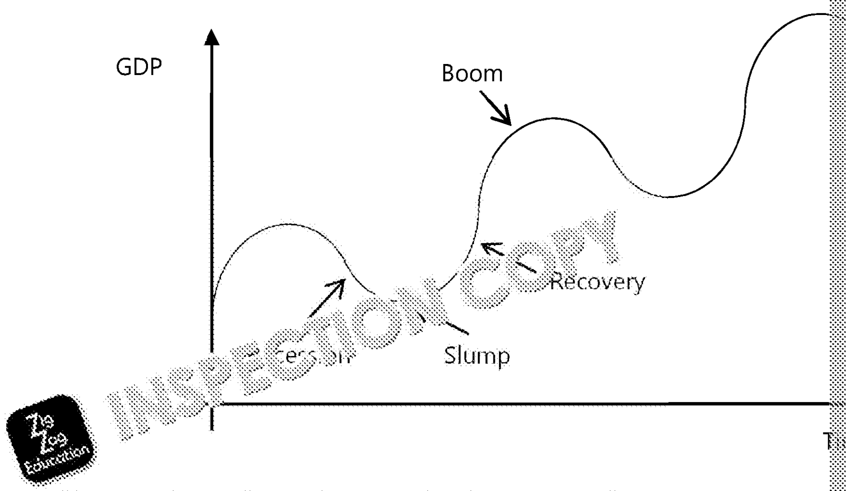
Source: http://www.washingtonpost.com/blogs/
biggest-chocolate-mak

2.5. Keywords

Competiti	When two or more businesses compete for the sa and/or market share
Market size:	Measurement of a particular market, such as the t total sales volume or profits
Market price:	The average price of a product/service depending to pay
Microeconomics:	Factors affecting businesses that are within their c
Macroeconomics:	Factors affecting businesses that are beyond their

2.5. Answers

1. **The following diagram shows an example of a business cycle.**
   a. **Complete the diagram using the terms *boom*, *slump*, *recession* a**



   b. **Identify one characteristic of each stage in the business cycle.**
   Answers might include (but not limited to):
   Recession: demand falls, output decreases
   Slump: demand is low, businesses charge lower prices to create sales r
   Recovery: demand increases, profits increase, new businesses can star
   Boom: demand is greater than supply, excess demand and so business

2. **Complete the following table to show either benefits or drawbacks t inflated economy.**

Benefits	
Businesses can increase their prices without raising suspicion *It raises the value of property and stock*	*Consumers may bec* *Business cash flow i* *Suppliers are able t* *Company workers n*

3. **The following shows a list of possible business effects and governm legislation to its correct effect.**

- Motivation increases as working conditions increase
- Enhanced company brand since it promotes a good working environment
- Improved qua[illegible] prod[illegible]
- Positive branding for any business that significantly reduces its harmful emissions
- Lowering prices in order to compete, which brings down profits

4. **A paper manufacturer is looking into ways that it can comply with e does not like the high costs that come with this. Explain two ways in benefit from complying with environmental policy.**
Students can explain any of the following:
- *Avoid fines for not complying with policy*
- *Build up the company brand as environmentally focused*
- *Doing fewer wasteful practices can save the business money*
- *The business can improve its branding with the environmentally*

5. **Explain why the following two market elements are important to a whether to introduce a new product/service:**
   a. ***Market price:***
   If there is a market for something, there is l... already a market pri sure that they can produce their goods, services for the right price tha Businesses can also consider ... potential for their goods if the to pay more.

   b. ***S... market:***
   If ... rket is small (i.e. there are few customers), the potential prof businesses can potentially make big money when selling to a large ma dictates how many consumers will be involved and so businesses need demand.

6. **Explain two ways in which consumers might suffer from increased**
Students may include any of the following drawbacks for customers:
- *Companies can become too focused on price in highly competitive to a reduction in quality*
- *Reduction in quality can also relate to health and safety issues fo*
- *If high competition causes a business to fail, consumers may suffe they are also part of the business's local economy)*
- *Businesses that grow and eventually consume smaller firms may behaviour, such as having great influence over the prices consum*

Keyword Glossary

Batch production:	When a business produces goods/services in grou
Break-even:	the point where total costs of producing a good/s revenue earned equal (i.e. where the lines on the
Cash:	Money available for payment of day-to-day activi
Cell production:	When a business splits itself into specialist areas, production of a good/service
Competition:	When two or more businesses compete for the sa and/or market share
Contribution:	The difference between the variable costs of prod amount of revenue a company earns from selling
Current assets:	These are assets that a business owns for up to a These assets are easier and quicker to convert int
Current liabilities:	debts that a company has and that will be paid w
Disposable income:	The amount of cash consumers have available to is absolutely necessary
Dividend:	The share of the profits that shareholders receive
Efficiency:	How much a business can achieve through a mini average costs
Fixed Assets:	Things such as property and equipment that are c
Fixed costs:	These are costs that do not change with the numb
Float:	When a company decides to trade its shares on th
Flow production:	A constant flow where a production line focuses o
Grant:	Cash that is given to a business. Unlike with loans grants back.
Gross profit:	The difference between revenue and cost of sales
Historical budget:	Companies create a budget based on those of pre
Job production:	When a business produces goods/services one at
Kaizen:	Employees are organised into groups (quality circ for continuously analysing, and improving, the pr
Liquidation:	A company's assets are no longer enough to pay close. The company will then sell off its assets in o
Liquidity:	The ability that a business has (through its assets)
Long-term liabilities:	Debts that a company has and that will be paid in
Macroeconomics:	Factors affecting businesses that are beyond their
Market price:	The average price of a product/service depending to pay
Market size:	Measurement of a particular market, such as the n total sales volume or profits
Microeconomics:	Factors affecting businesses that are within their c
Net assets:	This is what is left once all liabilities have been su calculation for this is Fixed Assets + Net Current A

Net current assets:	Also known as Working Capital, this is the finance its day-to-day processes. It is calculated with the Liabilities.
Net profit:	The profit left after deducting COS and all operati
Operating profit:	The difference between gross profit and other op
Over-utilisation of capacity:	When a business produces more goods/services t This can cause stress on overworked staff and mi downtime and maintenance of equipment.
Productivity:	A company's hourly rate of output per each input
Profit:	Money that is left after all expenses and dividend
Profitability:	How profitable a business is, comparing gross, op sales revenue.
Sales forecast:	A prediction of the sales a company will make in t
Sales revenue:	The amount of cash generated by selling product
Sales volume:	The number of units sold
Share:	Partial ownership of a company. If, for example, a and one person owns 10 shares, they own 10 per
Shareholder:	A partial owner of a company. Shareholders inves for a stake in its success.
Stock market:	A place where company shares are bought and so York and London stock exchanges.
TQM:	A constant, company-wide culture of quality man
Under-utilisation of capacity:	When a business produces fewer goods/services lead to staff being underworked, which may dem money on employees they do not need.
Variable costs:	These are costs that change according to the num
Variance analysis:	A method to demonstrate how much of its budge
Zero-based budget:	All departments in a company start with no budg company what they need in order to qualify for a

Focus: Answers

Focus Answers: Innocent Drinks

a) Identify and explain two reasons why a company chooses to issue s

Possible reasons may include (but are not limited to):

- Expansion: as a way to grow the business without having to invest
- Payback: investors do not expect payment from their share owner profit
- Low cost: the business does not have to pay anything in order to g

b) Explain two ways in which Innocent Drinks' success could have bee the Coca-Cola Company.

Possible ways in which Innocent Drinks could have been affected includ

- Marketing power: the company now has a lot more money behi campaigns and consumer surveys
- Investment: the Coca-Cola Company has a lot of funding that ca Drinks potential for firm growth
- Branding: Coca-Cola could bring Innocent Drinks to more custo never have done alone. On the other hand, Innocent Drinks may who do not agree with the ethics of Coca-Cola. This could create previous core customer base.

c) Compare the benefits and drawbacks of a business having unlimite liability.

Possible benefits and drawbacks for unlimited liability include:

- The owners are completely responsible for all debts that affect
- The law does not distinguish between a business and its owner
- The personal assets of the company owner are liable if the com
- Responsibility falls with the owner and so do all decisions

Possible benefits and drawbacks for limited liability include:

- It encourages shareholders to invest since they are only liable t
- The law separates the owners of a business and the business its
- The personal assets of the company owner are not liable if the c
- Though the business is helped by shared ownership, this can al are many voices all trying to guide the same business

d) Analyse why the Coca-Cola Company decided not to make many cha practices of Innocent Drinks.

Some of the points that students may consider in their analysis include (

- The already-existing branding of Innocent Drinks
- The customer base that Innocent Drinks has
- The expectations for a small business like Innocent Drinks
- The assumptions that consumers make about Coca-Cola and ho Innocent Drinks
- The marketing power that Coca-Cola has and which it could use Drinks

Focus Answers: Budgeting

Evaluate the validity of Herman Heyns's statement, comparing any busi to the drawbacks that Heyns mentions.

Some of the benefits that students could consider as part of their answer incl

- Budgets can be based on figures from previous years, which make t
- Managers can plan for what cash they will have available in future
- Companies can plan for periods when cash is tight and better under receive payments and need to settle debts
- Budgets help companies decide whether a project is worth taking o

Focus Answers: Coca-Cola

a) Calculate the following three figures for 2014, 2012 and 2010:
  i) Gross profit
  ii) Operating profit
  iii) Net profit

  i) 2014: $2,973m 2012: $2,900m 2010: $2,480m
  ii) 2014: $1,019m 2012: $928m 2010: $810m
  iii) 2014: $893m 2012: $837m 2010: $746m

b) Calculate the following three figures for 2014, 2012 and 2010:
  i) Gross profit margin
  ii) Operating profit margin
  iii) Net profit margin

  i) 2014: 35.98 per cent (to 2 d.p.) 2012: [illegible].97 per cent (to 2 d.p.)
  ii) 2014: 12.33 per cent (to 2 d.p.) 2012: 11.51 per cent (to 2 d.p.)
  iii) 2014: 10.81 per cent (to 2 d.p.) 2012: 10.38 per cent (to 2 d.p.)

c) Using data from your calculations, analyse whether The Coca-Co increasing or decreasing and suggest how the company could impr

Students should show that Coca-Cola's profitability has increased and de Gross and net profitability are lower in 2014 than in 2010 while operati though not by much. Students may wish to highlight the fact that we nee make a more accurate analysis.

Coca-Cola could improve its profitability in several ways, including (but

- Increase promotion of certain products in order to generate hig
- Decrease cost of sales by reducing the amount of raw materials product/service
- Increase employee efficiency
- Produce more goods in order to generate further sales
- Make cuts to the company's day-to-day expenses, only funding essential

Focus Answers: BMW

a) Assuming that the maximum capacity for Rover in 1999 was 100,00 maximum capacity for BMW in 2007 was 250,000 units, calculate th both.

1999: 56 per cent capacity utilisation
2007: 80 per cent capacity utilisation

b) Identify and explain two ways Rover could have improved its capac

Possible ways to improve capacity utilisation might have included:

- Sale of assets: if Rover had equipment/property that it wasn't full off in order to generate more cash for investment in the business.
- Employ more/fewer staff: perhaps the business had too many wo perhaps the opposite. If too few, the business could have been wo staff to support it. With too many, Rover would have been oversu product more expensive that it needed to be.
- Increase demand: if Rover had worked more at its promotional acti could have created more demand for its products and, therefore,

c) Compare the benefits and drawbacks of BMW investing so much mo

Possible benefits of investing funds in the Oxford plant include:

- The plant can purchase more equipment and machinery in orde the production process
- The plant can employ more staff and/or invest in training to inc
- BMW can purchase more supplies so that it can make better us demand

Possible drawbacks of investing funds in the Oxford plant inclu

- If a critical failure hits the plant, BMW will feel the effects since
- Consumer trends change and so the Mini may eventually fall ou less valuable
- Depending on available cash for th[illegible] business, BMW may other lucrative areas of the b[illegible]

d) BMW uses TQM in a[illegible] processes. Analyse the potential v draw from th[illegible]

Stude[illegible] demonstrate understanding of total quality managemen

Possible points to consider (not limited to):

- Businesses using TQM create a culture of constant quality manag employee the responsibility for their own set of tasks
- All staff will understand the main aim of a company as being qua
- Staff are encouraged to behave like supplier and customer, i.e. w from another department, they must consider whether it is good are produced to the best possible quality.
- TQM can slow down the production process since it requires all s give feedback before the good can be released on the market
- A culture of TQM can encourage employees to take great pride in improve motivation
- Employees are more invested in the business as they are all wor
- The culture of TQM is attractive to other potential employees wh TQM can also create a brand of high quality that consumers kno

Focus Answers: Chocolate

Consider the world demand for chocolate and evaluate the effects that c on chocolate-product manufacturers.

Students should consider the positive and negative effects that contingency p product manufacturers.

Possible points to consider:

- These plans are for emergency situations only, [illegible] no business truly situation until it has been in one. There[illegible] e plans do not neces crisis.
- Contingency plans depe[illegible] ability to forecast economic proble difficult to pred[illegible]
- Pla[illegible] to put together, especially when it comes to testin
- An[illegible]s better than no plan
- Rely[illegible] on a contingency plan is unhealthy for businesses; it would b supplier, or more than one production line, in order to better react to