

2.1.1 Internal Finance

Advantages

No credit checks
No interest or administrative costs
No need for third parties
Instant

Disadvantages

Can decrease debts if external
No inflationary benefits
Flexible
Conflict between shareholders
Potentially high opportunity cost
Not tax-deductible
Unlike external finance
No maintenance
Not tax-
deductible
Limited profit
- not applicable to no capital assets
Profit after tax
reinvested to the business
Profit

Retained Profit

Usually a businesses most important
No interest or administration
Cheap
Limited companies - money to buy shares
Redundancy payments
Capital
usually start-up finance
but is continued
Sole traders or partnerships

Sale of assets (sale and leaseback)

raise finance

sell unwanted assets

sell asset the business needs lease back

sale + leaseback instant cash

Can be used when large amounts are needed

could sell off branches

focus on other areas

own money

personal savings

capital

Risk

entrepreneur

sole traders or partnerships

usually start-up finance

but is continued



+ Identify timing of cash surplus/shortage

↳ determines when borrowing may be necessary (seasonal demands)

+ Supports finance application; indicates future outlook (& performance/ solvency docs)

+ Enhance planning

↳ Clarify aims

↳ Improve performance

(ID's problems in advance)

+ Monitors cash flow for comparison between projected & actual figures

↳ allows more effective management

— 1-dimensional, can't be used to evaluate business performance

— Too much time spent monitoring cash flow at expense of customer needs

— Focuses on one variable (cash), not profit & productivity

Difference between cash flowing in & out at the end of each month

Net cash flow

Cash flow forecasting

Solvency

↳ degree to which a business can meet its debts when they fall due

Prediction of all expected receipts/expenses of business over future period

Shows expected cash balance @ end of month

Investors know how money is being spent & benefit to them

Shows development plan & assists in finance application

Helps build investor confidence of success

Relevance of a Business Plan

Prospectus

↳ contains important b.p. elements & investor info

Forces owner to be objective & critical of idea

Provides 'road map' plan to 10 key tasks/goals

Flag problems

Demonstrates credibility

Contents of Business Plan

Executive summary

Business opportunity

Buying/production

Financial forecasts

See cash flow forecast

2.1.4 - planning

Estimates: hard to predict sales revenue for future

(ie: variable costs)

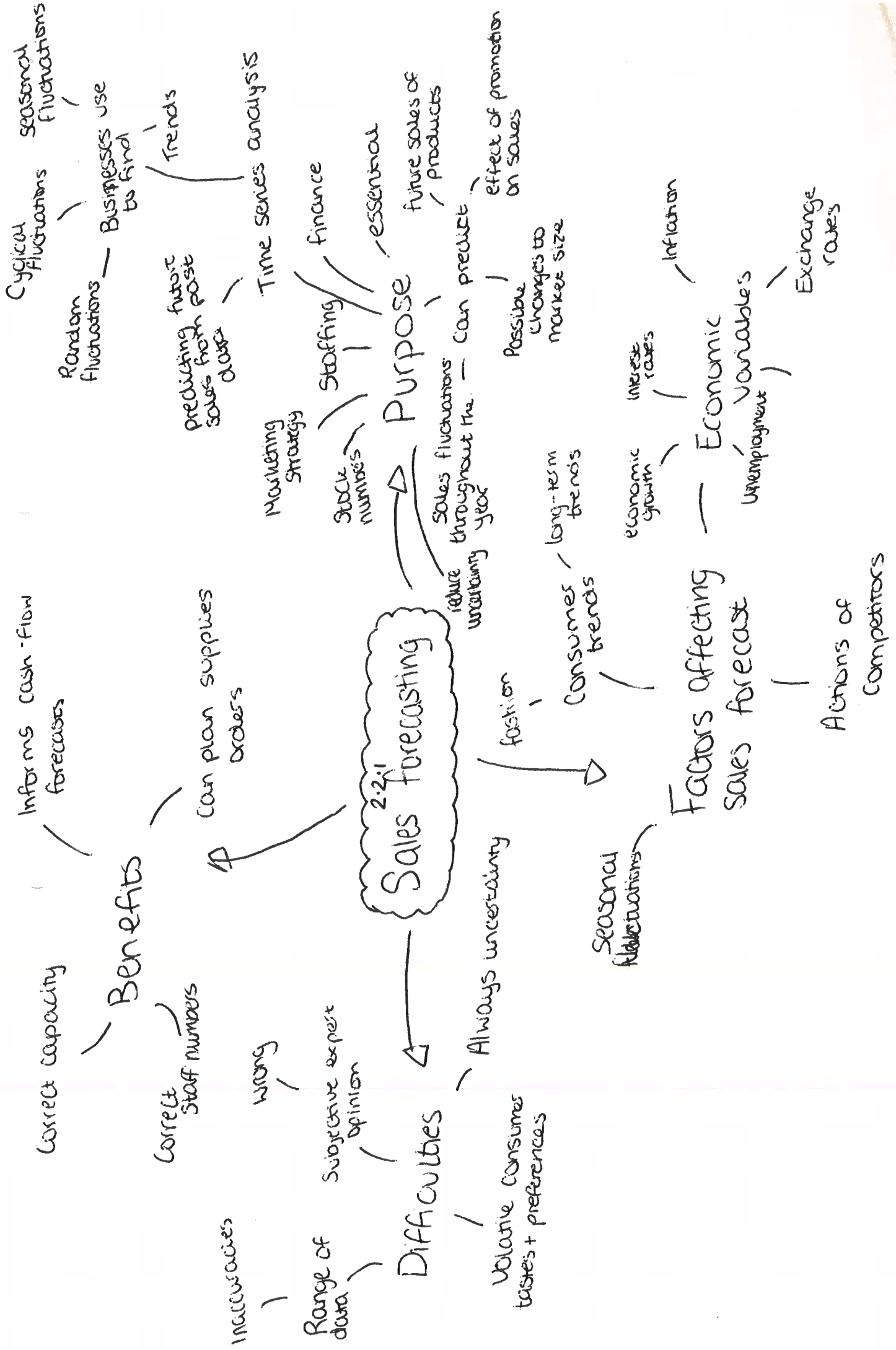
↳ results in an inaccurate inflow/outflow = not cash flow & closing balances

Subject to external forces (interest, exchange rates, legislative etc)

↳ impact costs/revenue

Too much time spent monitoring cash flow at expense of customer needs

Focuses on one variable (cash), not profit & productivity



Profit = £5 x 300,000
 - (£400,000 + (£2 x 300,000)) = £500,000
 ↳ If variable costs were £4/unit, business would make a loss

Eg. power generator = megawatts/hour sold
 ↳ if not, more meaningful to calculate sales rev.
 Works if business has a clearly identifiable unit of output
 No. of units sold by business
 Used to measure & monitor sales levels

Eg. toy store produces/sells 300,000 dolls, sell them at £3/w/ fixed costs of £400,000 & variable of £2/unit.
 Profits = total rev. - total costs
 Sales Volume

2.2.2 - Sales, Revenue & Costs

Average cost / total cost / output
 ↳ Average cost

Add together fixed & variable cost

output increase also means fixed costs become a smaller proportion of total
 Distinction between fixed & variable costs

Marginal Safety

Fixed costs which do not change directly w/output
 Lower risk for start up

Variable costs which directly change as output varies
 Cost of production increases directly as output rises

Can change in long run
 Eg. if firm is at full capacity but needs to increase production, it can invest in equipment = raise in overall cost

Doesn't mean costs don't change as a result of output in short run
 May + due to factors like inflation

Stays the same at all output levels
 Eg. rent, insurance, capital costs (ie. machinery)

Fixed Costs

Long run = all factors vary
 ↳ firm can buy another factory & add machines, which increases capacity & begins another short run period

Short run = period of time when at least 1 production factor is fixed
 ↳ ie. expanding production in factory: can acquire labor/materials but has fixed amount of machines/factory space

Business Costs

Sales Revenue

Value of output sold by a business
 Can be calculated for a specific time period (day, month, year) or individual products of wide range

Total rev. = vol. sold x average selling price
 Sales rev. = price x quantity of output

Importance of cost/ways for business to increase revenue
 ↳ Increase quantity sold
 ↳ Cut price over volume related to price? incentive

Achieve highest selling price
 ↳ Best to add value instead of increase price
 ↳ Does market research suggest that prices are too high/low?

Only linear relationships
 Particular set of conditions
 Assumes all sold
 Limitations of Break Even Analysis
 Only single product
 Only for set fixed costs
 They may be stepped if have more capacity

Contribution per unit x quantity of units sold = Total contribution selling price
 Variable cost per unit = Contribution per unit
 Contribution

Amount left over after subtracting variable costs from revenue
 Will contribute to fixed costs and profit
 Break Even

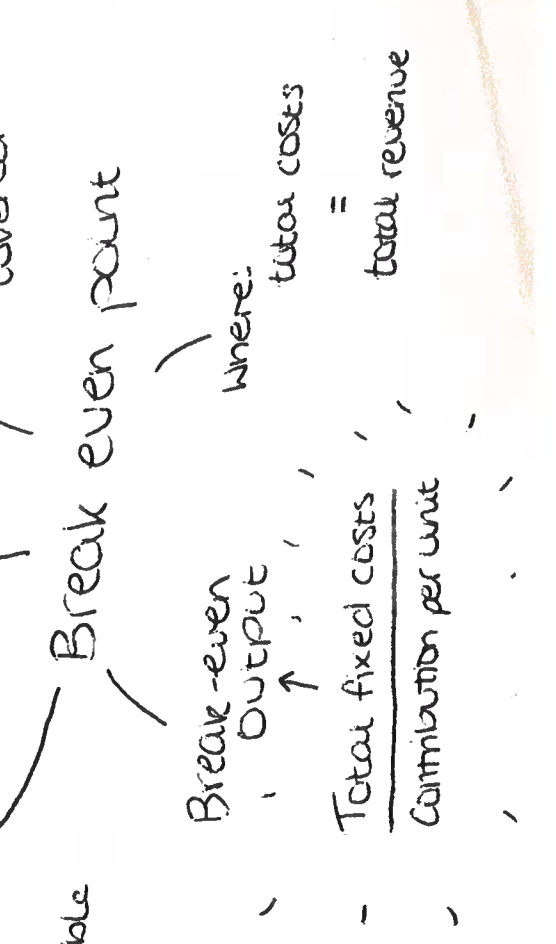
Neither a profit or a loss
 Break even point
 Larger = preferable if sales drop there is still profit

Break even point
 Break-even output
 Total fixed costs / Contribution per unit

Margin of Safety
 Range of output between break even and current output
 Break even output = Margin of Safety

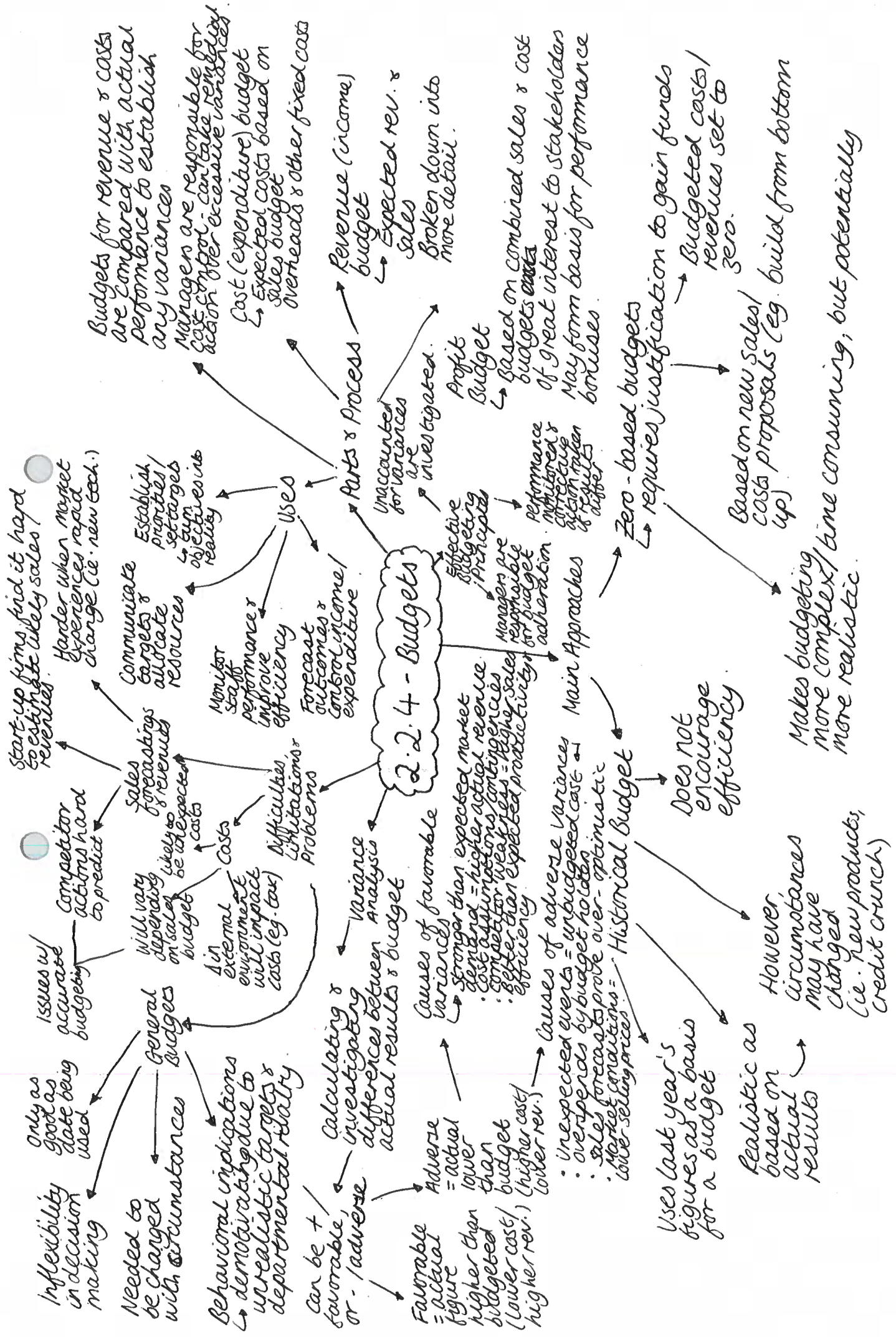
Break even charts
 Shows total cost, total revenue, fixed costs
 Break even point
 Number of units sold

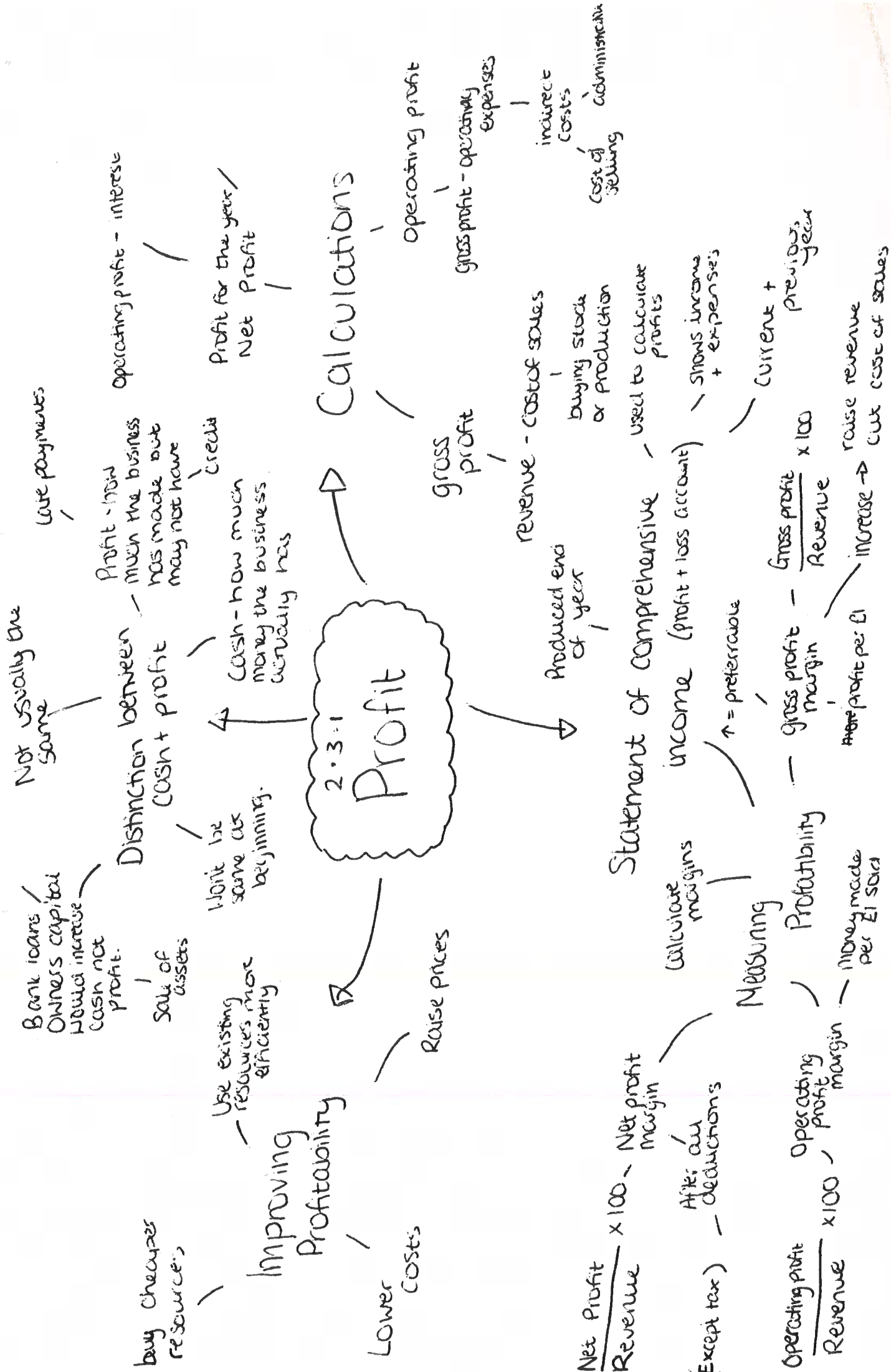
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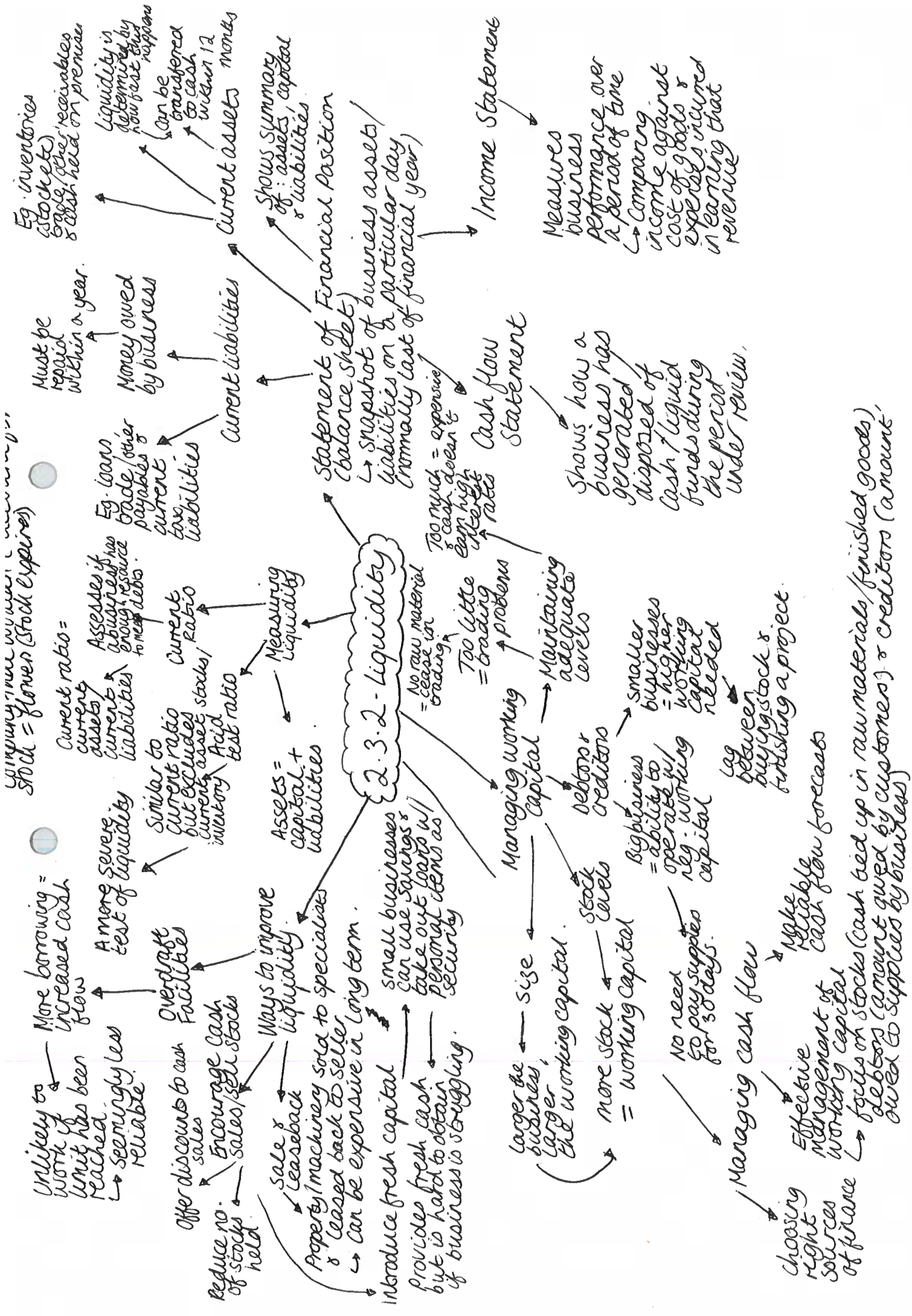
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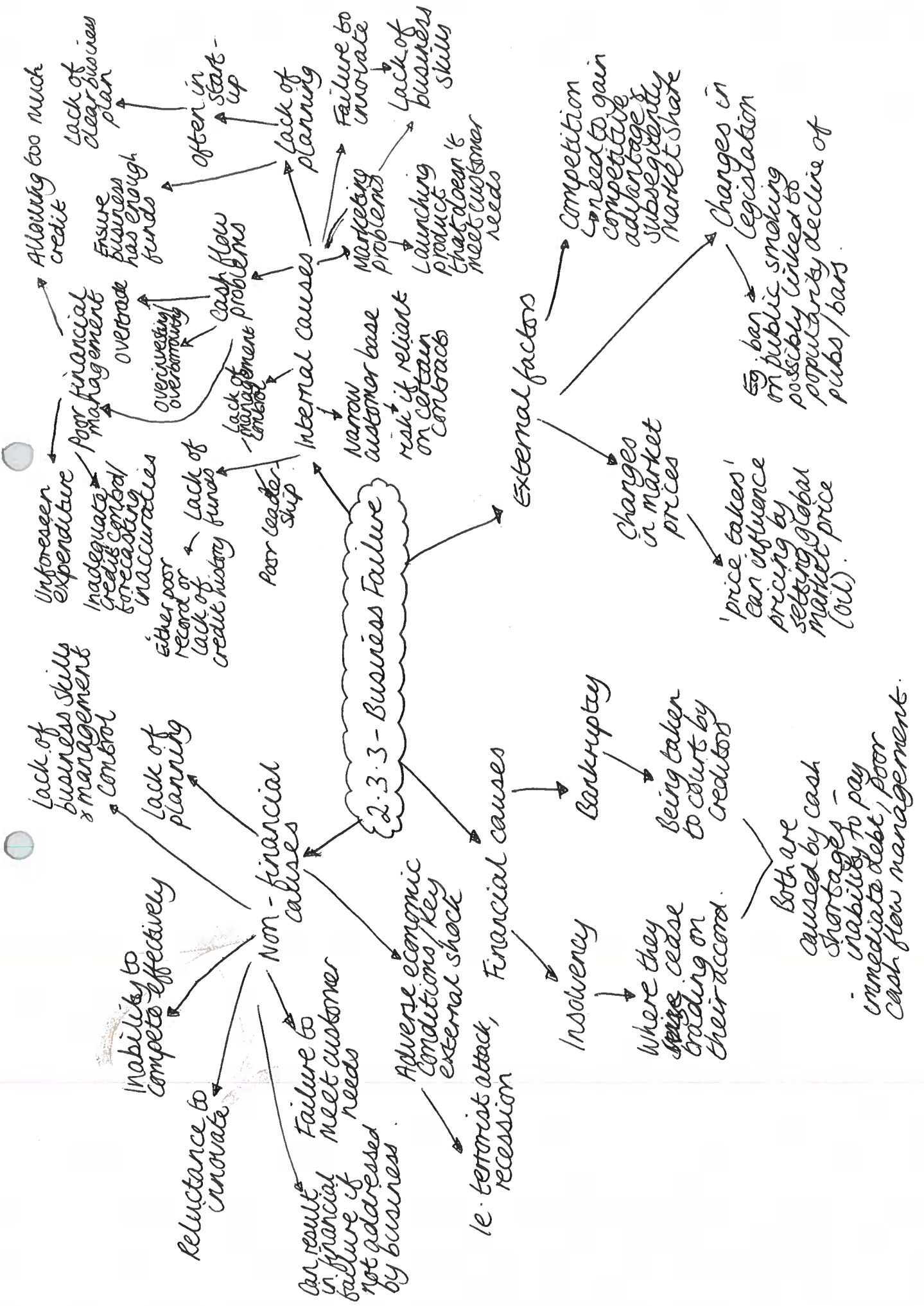
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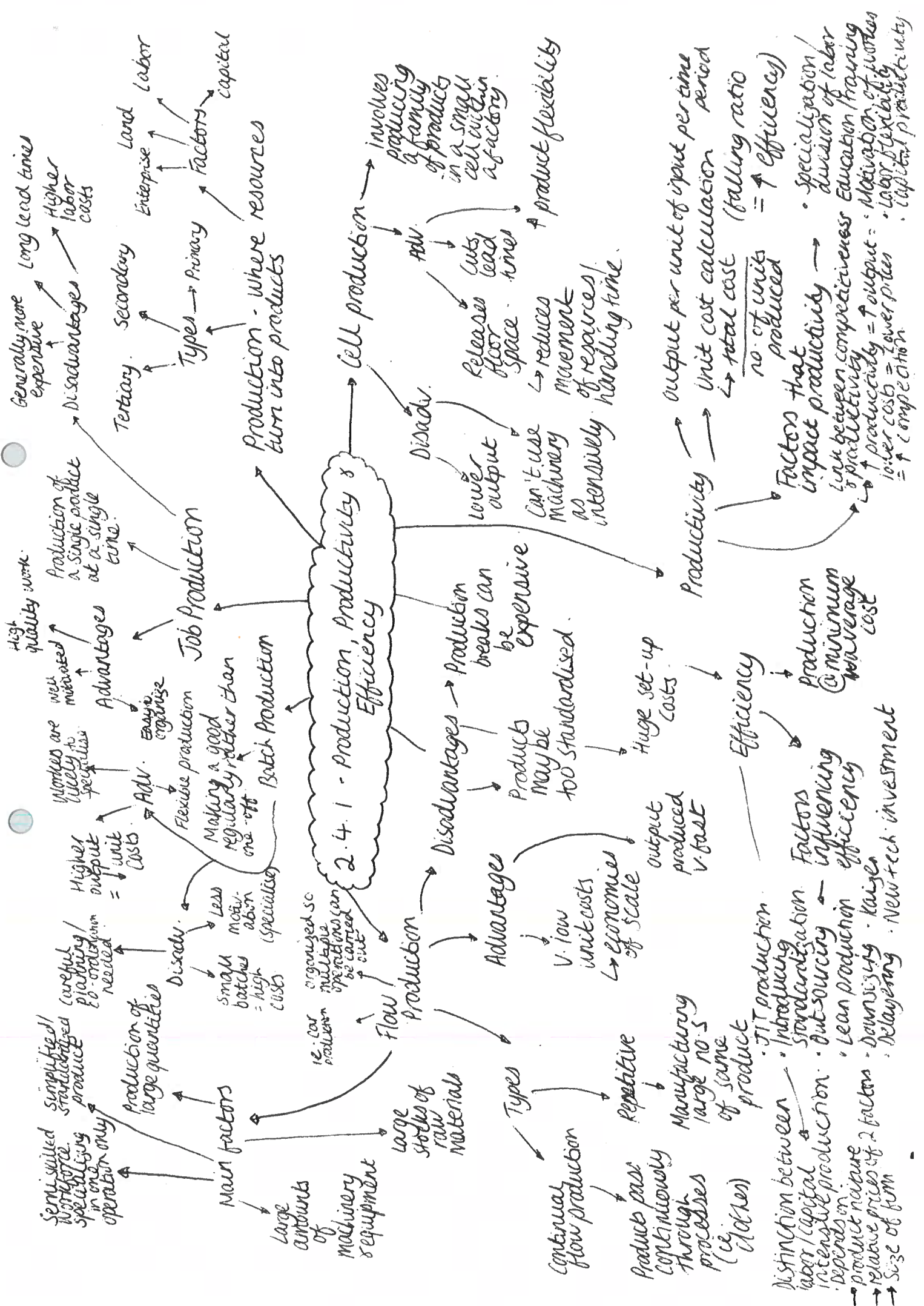




liquidity = how much money is available
 stock = money (stock expires)







Can ↑ workforce
accidents due to exhaustion.
Can stop
production
(which is
expensive).
Constant
working @
full capacity =
Strain of resources

Business may
not be able to
respond to demand ↑
Drawbacks

Benefits
→ Allows business
to cope more easily
w/ sudden
increases in
demand.
→ Less
work related
stress
reduces
absenteeism.

May occur w/ a drop in demand

Implications of
underutilization

Drawbacks → not making most
of resources =
inefficient operations
as unit costs aren't
minimized.
→ too much spare capacity
impacts worker
morale.
x 100

Calculation
→ $\frac{\text{Current output}}{\text{Maximum possible output}}$

2.4.2 - Capacity Utilization

Increases
competitiveness &
raise profits

Lower average
costs, as fixed
costs are spread
across more output units

Benefits

Lots of opportunities
to ↑ earnings through
overtime

Ways to
improve
Capacity
Utilization

Redeployment
→ if there are too
many resources in
one area, some can be
deployed to others.

Outsourcing

→ If capital
equipment has
low cap. utilization
rates, more
efficient to sub-
contract/subsidize.
→ = greater specialist
knowledge

Reduce capacity

→ Rationalizing - reduce excess
capacity by removing non-essential
resources.
Sell unused assets.
Mothball resources.

↑ sales

Can have
problems dealing
w/ peak demand
(↑ capacity utilization
during off peak time
via absenteeism)

More sales = more production = ↑ capacity
utilization.
Can mean more promotional spending.

Buffer Stocks

Emergency stock in case of surge in sales and stock shortage.

Stock Minimisation

Art hold stock for too long otherwise obsolete.

Administrative costs
Spoilage costs

Too Much
Shrinkage
Opportunity cost
Storage

Too Little
Will have space more orders miss out on bulk buy discounts.

Every a few hours before stock is needed.

Just In Time Management of Stock

Improves cash flow
Reduces wasted stock
More space

Intakes w/ supplier improved
More co-operation with workers

Suppliers need to be reliable + flexible
Ordering costs
No build buying advantage.

Lean Production
Use fewer resources in production.

Raises productivity of running due to demand.
Reduces costs cuts lead time

Re-order based on lead time.
Re-order quantity
Max stock level
Min stock level

Stock level
Lead Time
Time

Examples

Raw materials

Work-in-progress.

Finished goods

External factors

Demand

Stockpile goods (seasonal)

Cost of stock holding

Amount of working capital available

Type of stock

Factors that influence

Lead time

Stock Control Diagram

Stock level

2.4.3 Stock Control

Re-order based on lead time.

Re-order quantity

Max stock level

Min stock level

Lead Time

Time

Stock level

Time

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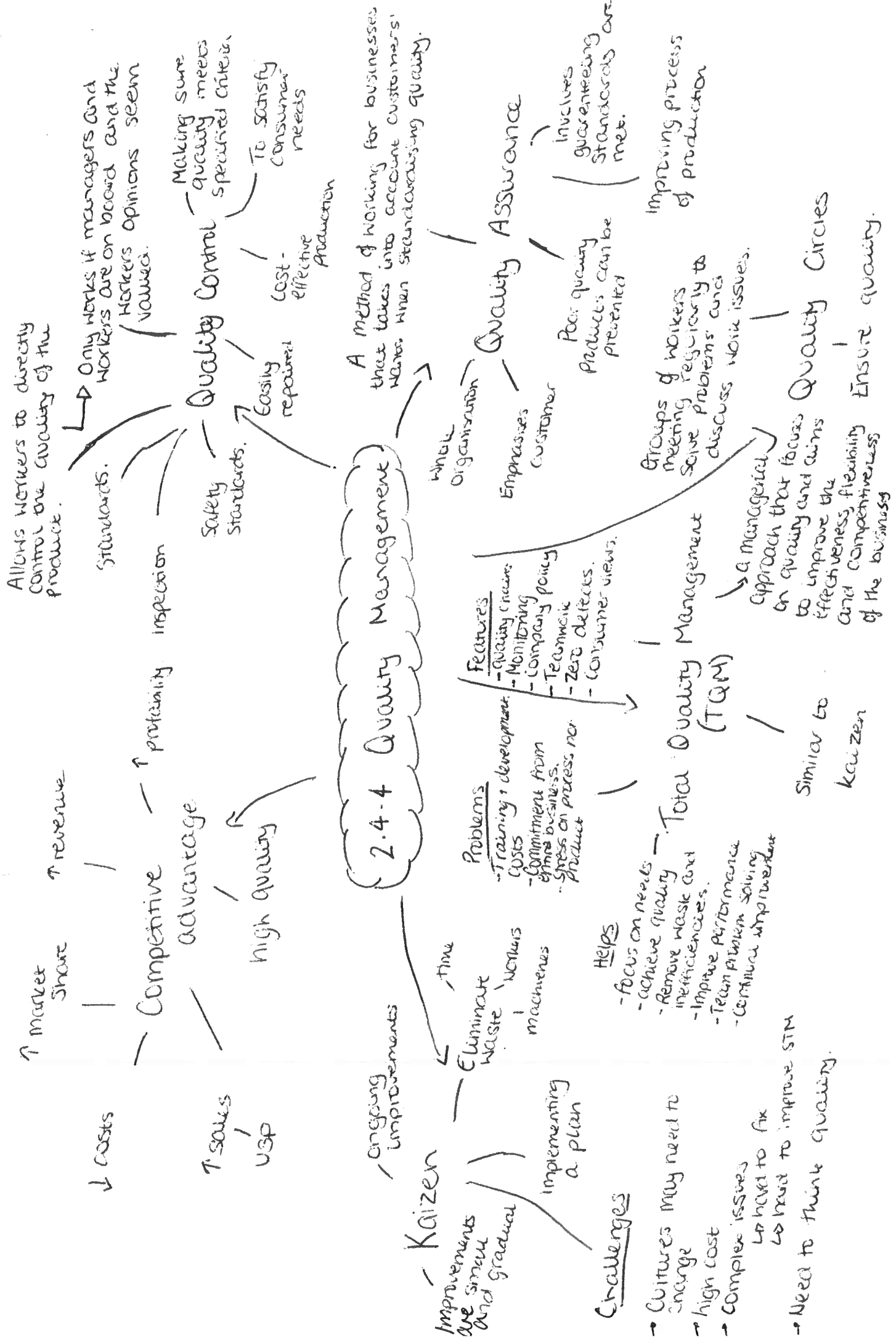
Min stock level

Lead Time

Time

Stock level

Time



High Effect

- Significant export sales (many airlines)
- Operations overseas earning foreign profits
- Significant overseas purchases
- Substantial demand from overseas
- Little elastic demand
- Firms costs need to be absorbed via profit margin

Low Effect

- No export - all turnover in domestic market
- Low materials etc bought in
- Demand mainly from domestic customers
- Inelastic demand
- Higher costs can be passed on to customers to maintain margin

Cost push

- when costs ↑
- demand pull: where there is demand (↑ economy)
- workers may demand ↑ pay to compensate for cost of living ↑
- labor interest in inflation

Price of one currency expressed in another

- impacted by supply & demand
- Exchange Rates

Monetary policy

- Monetary value ↑
- Rev. = ↑ revenue
- Marginal
- Hikes using debt as a source of finance
- Stable, low inflation
- Sets target @ 2.2%
- CAI - main UK measure of inflation

Effect on business of change in:

- Inflation**
 - Sustained ↑ in average price level of economy
- Interest Rates**
 - Demand for saving / cost of borrowing expressed as a % of money saved / borrowed
- Taxation**
 - Direct Tax
 - Income tax (progressive)
 - National Insurance
 - Corporation Tax (18/20%)
 - Capital tax
 - Capital gains
 - Inheritance tax (40%) on size of land own
 - Indirect Tax
 - VAT & Excise
 - Stamp Duty
 - Local Council Tax

2.5.1 - Economic Influences

- Business Cycle**
 - Impacts:**
 - Growth: ↑ Boom ↓ Slow ↓
 - Prices: ↑ Fast ↑ Steady ↓ Slow ↓
 - Unemployment: ↑ (U.I.) ↓ Slow ↓
 - Regular patterns of up & down in economy measured by GDP from one year to another**

Fiscal policy

- involves use of government spending, taxation & borrowing to affect level & growth of aggregate demand
- Budget & jobs

When they:

- ↑ disposable income
- ↓ mortgage cost
- Exchange rates & exports
- Cheaper currency & exports
- ↑ consumer confidence / spending
- Cost of servicing loans
- debt ↑ = ↑ spending power
- Business investment should be boosted - e.g. prospect of ↑ demand
- Housing market effects - ↑ demand
- ↑ property prices

Alternating stocking / destocking periods

- ↑ in value of consumer spending
- ↑ in levels of business consumer confidence

Main Causes

- ↑ in government policy in economy
- ↑ in consumer spending
- ↑ in business investment

Stages

- Boom: ↑ consumer spending, business confidence, profit, investment, price / cost ↑ fast, low unemployment
- Recession: ↓ levels of spending / confidence, profits = ↓ investment, spare capacity ↑, rises in unemployment
- Slump: break spending, investment, business failure, ↑ unemployment (rare), many causes & price
- Recovery: ↑ spending, confidence, investment, takes time to slow rate of unemployment

