

COMPONENT 3 – Promotion and Finance

Elements of the Promotional Mix

A1

- Learning Aim A : Promotion

What is promotion?

Promotion is any method of communication that tries to encourage current and potential customers to buy products. Examples include adverts on television and money-off coupons in magazines



The purpose of promotion

Promotion can be used to:

- Create a positive image of the enterprise in the minds of current and potential customers
- Encourage current and potential customers to buy products

The use of advertising to persuade and inform. The two basic aspects of advertising are:

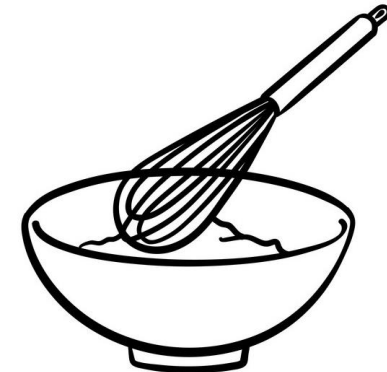
The message	What the communication needs to say about the product. <ul style="list-style-type: none">▪ Low price▪ Quality▪ Useful
The medium	How to get the message across by choosing the correct method of advertising to reach current and potential customers.



Promotional mix

There are many different methods of promotion used to get current and potential customers to buy products.

Enterprises will choose a combination of methods depending on their product and their suitability for the **size of the enterprise**. This is known as the promotional mix.



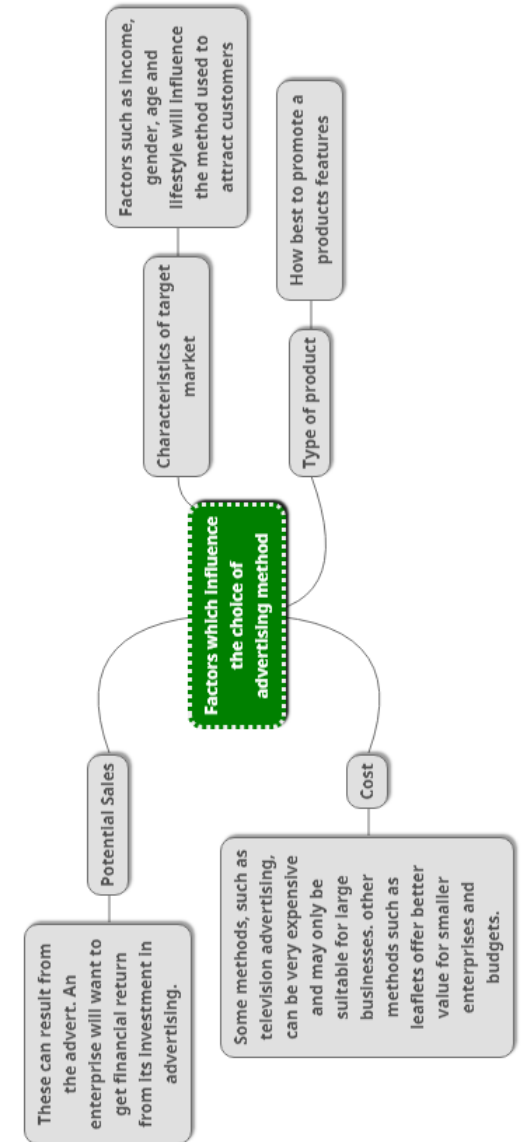
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Methods of advertising	Where advertising appears	Benefits
Moving image	<ul style="list-style-type: none"> ▪ Television ▪ Cinemas ▪ Video sites ▪ Promotional DVDs 	✓ Enables products with moving parts of a practical use to be seen in action and where/how they can be used
Print	<ul style="list-style-type: none"> ▪ Local and national newspapers ▪ Magazines ▪ Leaflets ▪ Billboards 	✓ Likely to be seen by large numbers of people, either in a specific location (local newspaper, billboards and leaflets) or over a wide geographical area (national newspapers and magazines).
Ambient	<ul style="list-style-type: none"> ▪ Public places, such as bus stops and shopping centres 	✓ Outdoor advertising aims to catch the attention of passers-by
Digital	<ul style="list-style-type: none"> ▪ Company websites ▪ Social media [Pinterest, Instagram] 	✓ Enables large and small businesses to connect with large numbers of people instantly
Audio	<ul style="list-style-type: none"> ▪ Local and national radio 	✓ Allows businesses to speak directly to their target market

Elements of the Promotional Mix **A1**



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Purpose of sales promotion

Enterprises use sales promotion for different reasons.

- To entice people into a shop where they may buy the product but other products also
- To boost sales figures
- To attract first time buyers
- To sell off older or less-fashionable goods to make space for new items
- To maintain customer loyalty

Method and features	Benefits/Limitations
Coupons Money-off voucher	➡ may encourage purchases ➡ impacts profit if doesn't cover cost
Free sample Often given with coupon	➡ potential repeat sales ➡ could impact profit
Competitions Prize draws	➡ builds up marketing – thrill means more entrants ➡ impacts on profits
Money off discount Percentage reduction	➡ encourages purchases ➡ profit affected if sales are low
Loyalty incentive Points towards other product or free items	➡ long term customer relationships established ➡ impacts on profit if too few sales generated
Buy-One-Get-One-Free Free product on purchase of a full price product	➡ encourages additional purchases ➡ profit impacted if sales are low

Elements of the Promotional Mix **A1**

Personal selling

This is where a representative of an enterprise contacts potential customers directly. There are 4 main methods of personal selling:

1. Face to face

The sales person is in direct personal contact with the customer

2. Telephone

The sales person makes phone calls to the customer [usually from a call centre]

3. Email

The sales person communicates electronically with the customer.

4. Video or Web conferencing

The sales person communicates with the customer through a webcam.

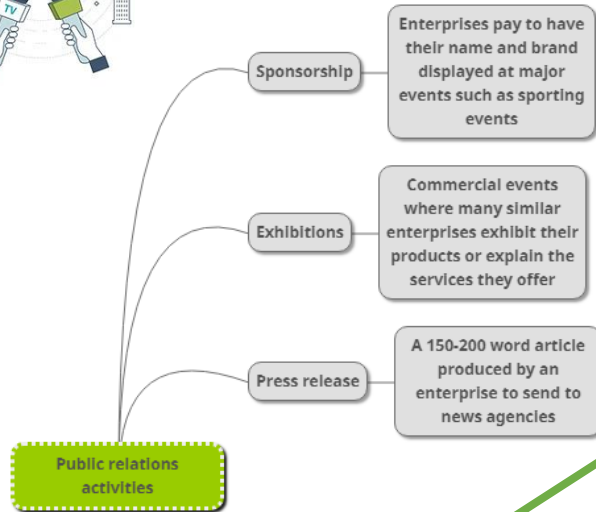


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An enterprises public image is an essential aspect of its success. A poor reputation may lead to reduced sales and a fall in profits. A positive image can maintain or even increase sales. Public relations (PR) involves building and maintaining an enterprises reputation – its image – through the media.



The purpose of public relations

PR may be used to promote products. Its purpose is to:

- Encourage positive views
- Encourage positive publicity through media
- Protect the brand image

Public relations



Telemarketing

Sales representatives make phone calls to inform customers of offers or new products (cold calling)

Email marketing and text messaging

Both may include links to the enterprises website.

Magazines

Enterprises own magazines including features and news of its latest products, or specialist magazines targeting a specific market

Mail order catalogues

Include photos and descriptions of products and information on how to order. Used by enterprises selling a wide range of products.

Direct mail [junk mail]

Leaflets, letters and brochures about new products. Suitable for a small enterprise such as a local restaurant or service.

Direct marketing is when an enterprise communicates with a customer directly to try to sell them something, either by phone or written communication

Direct Marketing

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Targeting and segmenting the market

A2

Markets can be sorted into different sections, known as segments. Each segment is made up of consumers with shared characteristics, needs and interests. Enterprises segment their markets for various reasons.

Enterprises decide on the most suitable promotional mix based on whether they are targeting a business-to-business (B2B) market or a business-to-consumer (B2C) market.

B2B

An enterprise sells its goods to another enterprise. The goods may be raw materials, equipment, consumables (items that are used up and replaced) or items for resale. This type of market is known as Business to Business (B2B).

B2C

An enterprise sells its products – goods and services – directly to individuals for their own use. Such individuals are known as consumers, and the type of market is known as Business to Consumer (B2C).

Markets can be segmented in different ways. Enterprises may target one or more segments. They may also target different categories within each segment. The segments include:

Demographic: Characteristics of consumers

Geographic: where consumers live

Behavioural: how customers behave (spending choices, frequency)

Psychographic: social class, attitudes, lifestyle etc.

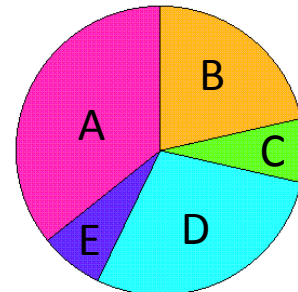
Market segmentation

This is the process of breaking down a large market into much smaller groups of consumers.

Enterprises analyse the market, and divide it into segments, each containing consumers with similar characteristics.

Why enterprises segment the market:

- ✓ To better understand the characteristics, needs and interests of current and potential customers
 - ✓ To develop products for a particular market segment
 - ✓ To develop products that suit the needs of different market segments
- ✓ To choose promotional methods that are better suited to the target market.

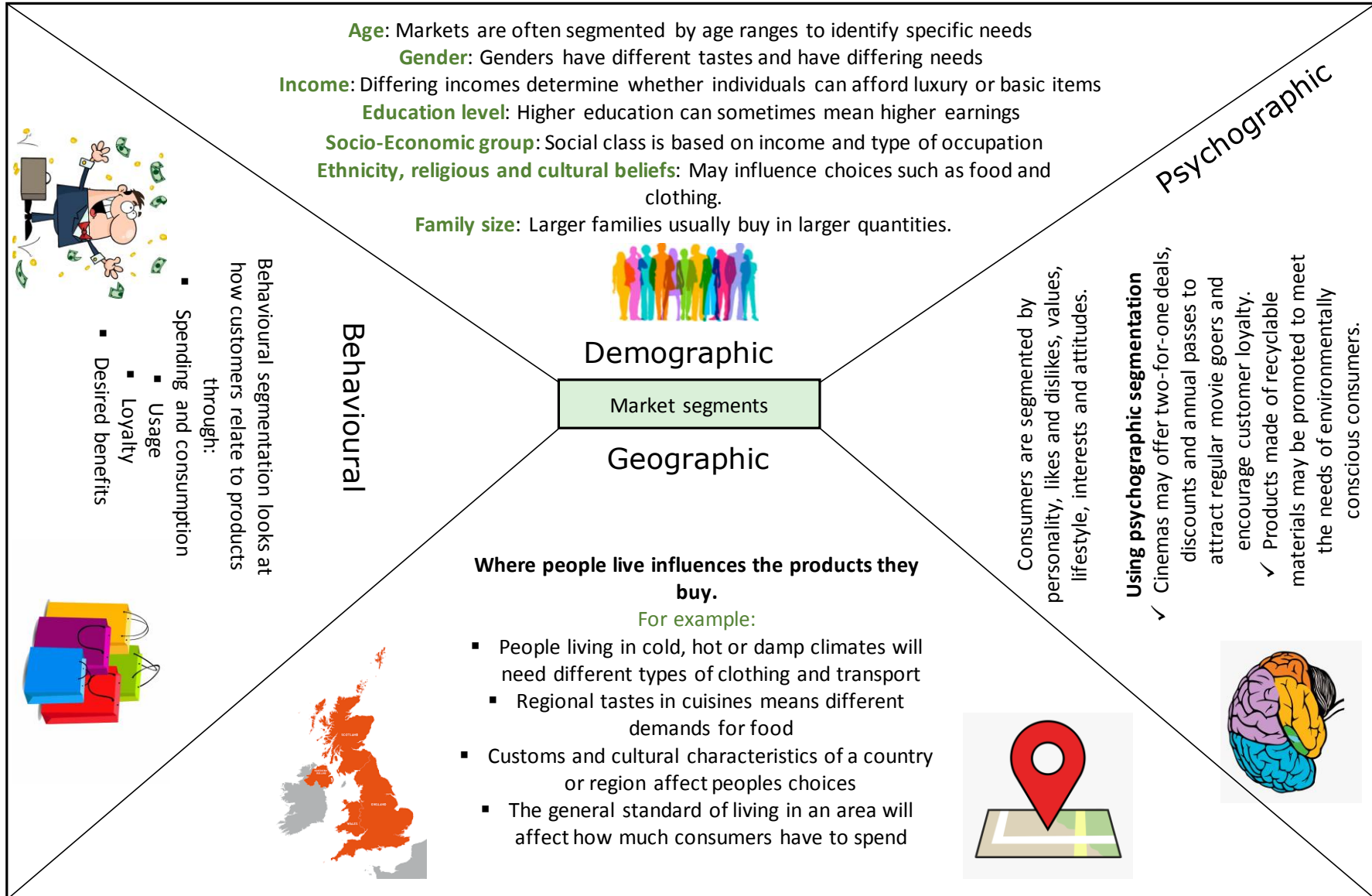


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Targeting and segmenting the market

A2



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Factors influencing the choice of promotional methods **A3**

Large enterprises

These are likely to:

- Have a large promotional budget
- Use all of the promotional methods you have revised
- Employ specialist staff to plan and manage promotional methods
- Employ a team of sales staff to promote products
- Hire public relations specialist and agencies to promote the brand

Smaller enterprises

These are likely to have:

- A limited promotional budget
- A narrower range of promotional methods as some would be too costly

They are unlikely to employ specialist staff. Promotions may only run at certain times to keep costs down. These may be linked to the skills of the owner and employees, the type of products, the size of the market and the budget.

Enterprises need to choose methods that are appropriate for the product based on its size and audience.

The promotional budget

Both large and small enterprises set aside money to run promotional activities.

Budget size is based on:

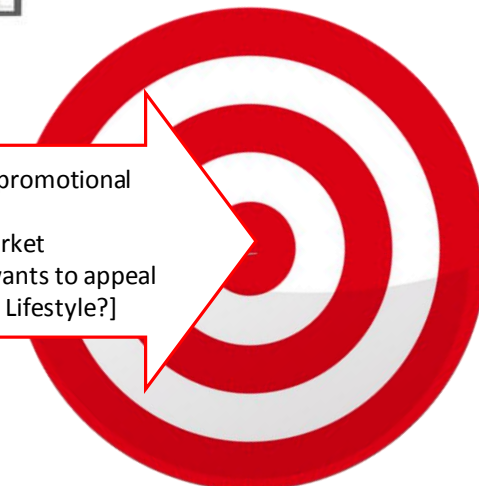
- Size of the enterprise
- How much competition there is – the more competition the higher the spend may be
- Sales revenue – the money received from sales

Budgetary constraints

- Promotional methods may be limited in scope for smaller enterprises with smaller budgets
- Decisions on spending may be influenced by product lifecycle. For example, new products may require a bigger budget than a product with steady sales
 - Poorly performing enterprises may have to restrict promotional activities to those that generate most sales



- To have positive impacts on sales, promotional methods must:
1. Reach the target market
 2. Be based on their habits and wants to appeal to them [Reading? Hobby? Lifestyle?]



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Financial documents

B1

- **Learning Aim B** : Financial records

Enterprise use a range of financial documents throughout the buying and selling process to record the sale and purchase of goods and services.



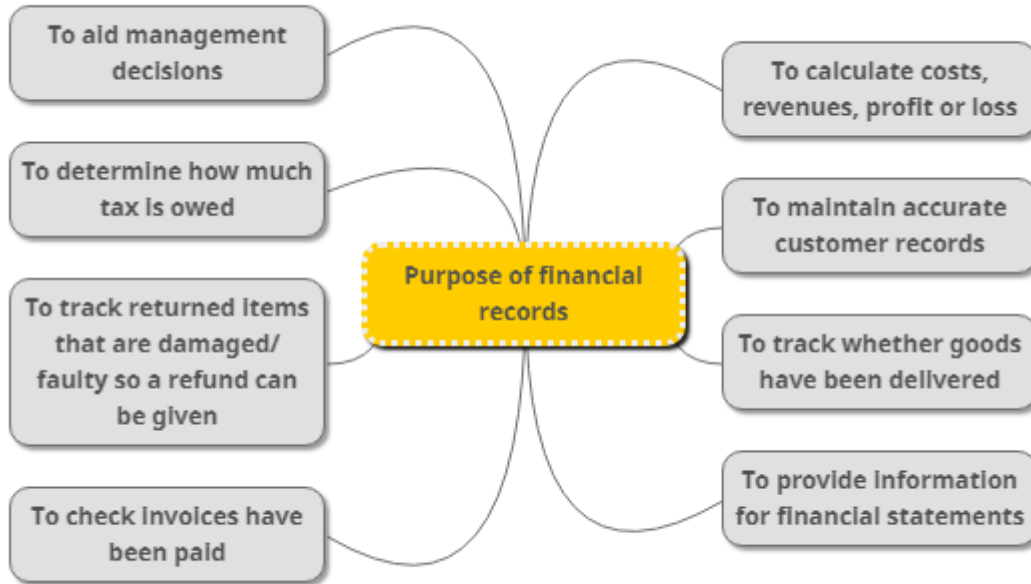
Document	Description	Document	Description
Purchase order	<ul style="list-style-type: none"> • Completed by buyer (the customer) • A legal offer to buy goods from the supplier • List items required, including price agreed and quantity • Sent to the supplier requesting products 	Receipt	<ul style="list-style-type: none"> • Completed by supplier and sent to the customer • A record of payment made by the customer • Rarely used when enterprises sell goods on credit (see statement of account)
Delivery note	<ul style="list-style-type: none"> • Completed by supplier • Sent to customer when goods delivered • Lists details about the order, including contents of delivery • Lists any goods not supplied, with reasons for non-delivery • Used by the customer to check that goods delivered match goods requested on the purchase order 	Credit note	<ul style="list-style-type: none"> • Completed by supplier and sent to the customer • Lists any goods that may have been returned by the customer • Confirms money refunded to the customer or may be used against the purchase of other goods by the customer in the future
Invoice	<ul style="list-style-type: none"> • Completed by supplier • A request for payment – sent to customer, either on receipt of goods or shortly after • List price of goods delivered, delivery charges and amounts owed to supplier • States date by which money must be paid • Explains how to pay, for example by bank transfer 	Statement of account	<ul style="list-style-type: none"> • Completed by supplier and sent to customer • A financial summary of the goods ordered, purchased or returned by the customer over a period of time, usually a month • Some enterprises pay their invoiced only after receiving the statement

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- Learning Aim B : Financial records

Accuracy of financial documents

B1



Importance of accuracy	
Importance of keeping accurate records <ul style="list-style-type: none"> ▪ Ensure correct goods are delivered in correct quantities ▪ Check customers aren't being under or overcharged ▪ Ensure there is enough stock to meet customer demand ▪ Ensure calculations of costs and revenues are accurate ▪ To ensure enterprise and customer have a clear understanding of the terms of sale ▪ Enable the enterprise to accurately calculate the taxes it owes the government ▪ To allow managers to make strategic decisions 	Problems with inaccurate records <ul style="list-style-type: none"> ▪ Profits may be over or understated ▪ Not all costs are accounted for ▪ Investors may lose confidence in the business ▪ Reputation for the business can be damaged ▪ Financial statements will not be accurate ▪ It can lead to cash-flow problems ▪ Suppliers and other trade payables may not be paid on time ▪ Bad debts can increase

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Debit card

Issued by banks to their customers (account holders); card is linked directly to the bank account.

Credit card

Issues by banks and financially companies. Allows you to spend to your limit and pay back at the end of the month

Direct debit

An instruction to a bank authorising a third part, such as enterprise, to transfer money of various accounts to its own bank on an agreed date. This is such as a phone contract that is taken on the same day every month.

Cash [notes and coins]

Accepted in most places as a form of payment. Money can be withdrawn from a bank account with the use of a debit card. Some shops only accept cash if they do not have the technology available.

Payment technologies

This could be such as PayPal which allows individuals to transfer money safely between buyers and sellers. Money is added/ withdrawn from the individuals bank account.

Cheque

A written order to pay a sum of money from a bank account to the payee. This is a declining method of payment.

Positive impacts on customers and enterprises

- ✓ Direct payments
- ✓ Safety
- ✓ Pay for large amounts in one go
- ✓ Can be used remotely
- ✓ Set limits to reduce overspending
- ✓ Easier shopping online
- ✓ Interest free periods

Negative impacts on customers and enterprises

- X Theft
- X Identity theft
- X Charges from banks
- X Available funds in bank
- X May be limited where can be used
- X Mistakes made
- X May not be suitable for online purchases

Payment methods

B2

Payment methods

There are many different ways for enterprises and their customers to pay for goods and services. Depending on the type of financial transaction, some methods are more suitable than others.



Factors influencing customers choice of payment methods

Convenience

Safety and security

Cost

Ability to pay

Lifestyle

Technology

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- **Learning Aim B** : Financial records

Sources of revenue and costs

B3

Income from sales

This is the most common form of income. Income from sales is known as revenue or turnover

- Cash sales from over the counter
- Credit sales from methods of credit such as a credit card
- Commission received from sales the business has supported
- Repairs of products previously purchased
- Maintenance contracts to regularly service a product and keep it in working order

Income from assets

An asset is something owned by an enterprise, such as property or equipment. An asset can be sold to generate income for the enterprise. There are many ways to generate income from assets:

- Lease or hire out equipment
- Invest in another enterprise to receive a share of its profits
- Put spare cash into an account that pays interest
- Sell assets such as property or equipment to raise money
- Rent out part of the premises to another enterprise.



Start up costs

Before trading these help to set up the enterprise

- Start-up costs will be influenced by the type of enterprise. For example:
- A clothing manufacturer will require an industrial premises, machinery and materials to produce goods.
 - A high street retailer will require shop premises, shop fittings and items to sell.

To pay for these the enterprise needs to source the start-up capital. This could be from owners own money, money loaned from family and friends, business loan or an investor

Running costs

There are two types of running costs



Fixed costs

These are costs that the enterprise has to pay n mater how well it is doing.

- Heating and lighting charges
 - Rent
 - Insurance
 - Business rates

Variable costs

These costs are directly linked with the number of items produced or sold. For example:

- The more orders a clothing manufacturer receives for t-shirts the more material it will need to produce them
- The more vehicles a car mechanic repairs and services, the more replacement parts would be required.

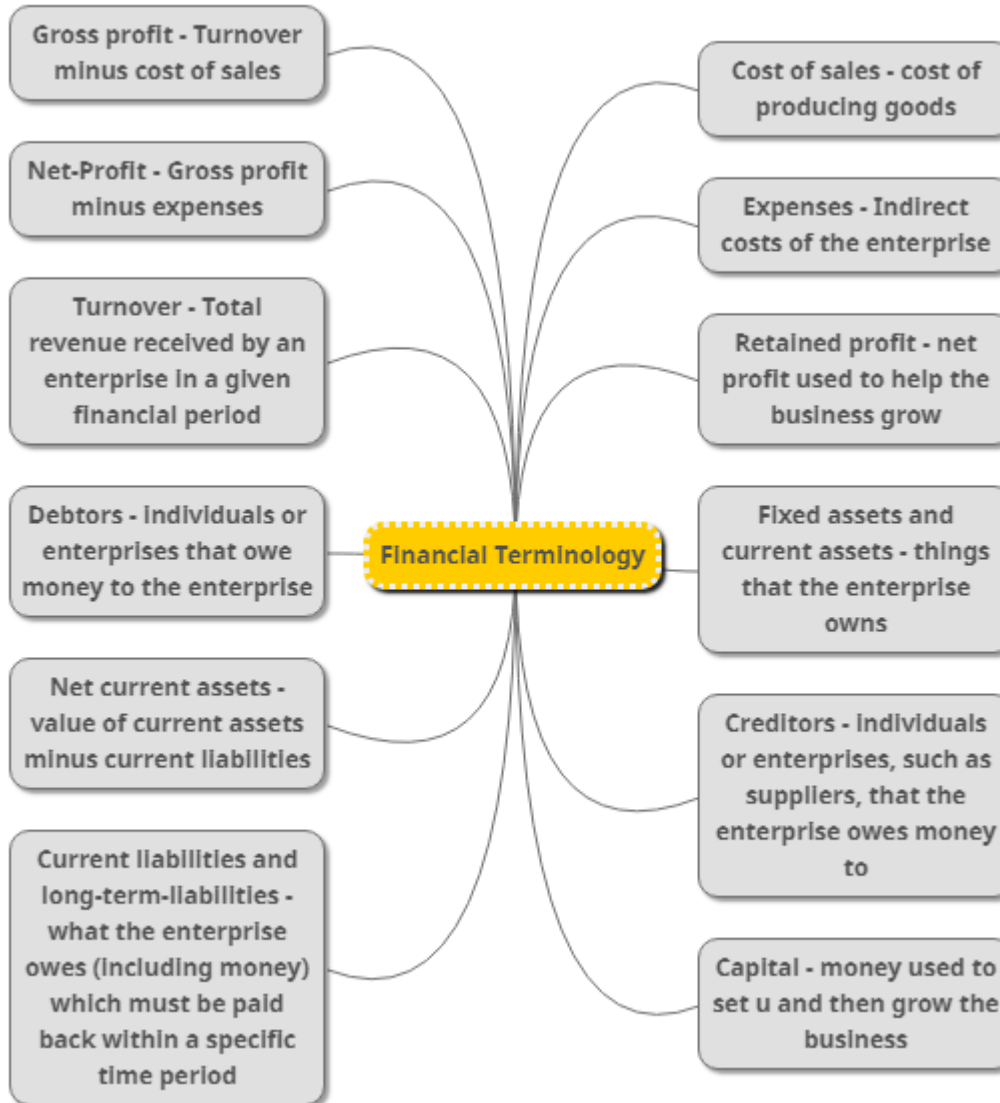
Total running costs

Fixed costs + variable costs

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Terminology in financial statements **B4**



Understanding terminology

You may come across the terms below by different names elsewhere.

The different terminology is shown in brackets – they mean the same thing:

- Debtors (trade receivables)
- Creditors (trade payables)
- Fixed assets (non-current assets)
- Long term liabilities (non-current liabilities)

Financial terminology often appearing in financial statements

Statement of comprehensive income	Statement of financial position
Turnover, Cost of sales, gross profit, expenses, net profit, retained profit	Fixed assets, current assets, owners capital, current liabilities, long term liabilities (non-current liabilities), debtors (trade receivables), creditors (trade payables)

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• Learning Aim B : Financial records

A statement of comprehensive income is a summary of the enterprises activities over a specific period of time, usually a year. It is used by several interested groups of people to understand how well the enterprise is performing.



	£	£
Sales revenue		15 400
Cost of sales		5 200
Gross profit		10 200
<i>Less expenses</i>		
Wages	2 800	
Rent	1 200	
Marketing	500	
Transport	1 800	
	6 300	
Net Profit		3 900

Sales revenue – This is the revenue received by the business from selling its products. It is also referred to as simply **sales** or **turnover** (net sales) because it takes into account any price discounts or goods returned by the customer

Cost of sales – this includes the cost of making the products.

Gross profit = turnover – cost of sales

Expenses – These are the indirect costs incurred when running a business. Expenses are listed separately in the statement of comprehensive income.

This is the total of the individual expenses.

Net profit – Once sales, cost of sales and expenses are identified, the net profit or loss can be calculated: $\text{Net profit} = \text{Gross profit} - \text{Expenses}$

In financial statements if figures are shown in (brackets) they are **negative**. The minus sign is not used

Profit

On the example above both gross profit and net profit were positive figures, which means the enterprise made a profit.

Loss

If total costs (cost of sales + expenses) are greater than the revenue, the enterprise will make a loss, as shown in the example.

Statement of comprehensive income

B5

Interested groups
Several groups of people will be interested in the comprehensive statement of account as they will want to know if the enterprise is being well run.

- Managers
- Employees
- Shareholders
- Suppliers
- Customers
- Tax authorities

Purpose of comprehensive statement of income
The financial statement shows:

- How much revenue the enterprise has received from sales of goods and services
- How much the enterprise has sent
- Where the money was spent

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- Learning Aim B : Financial records

Statement of financial position

B6

	£	£
Fixed assets		
Computer	500	
Vehicle	2 000	
		2 500
Current assets		
Inventory	4 000	
Debtors	600	
Cash in bank	2 000	
		6 600
Current liabilities		
Creditors	700	
Overdraft	300	
		1 000
Net current assets		5 600
Total assets less current liabilities		8 100
Financed by		
Owners capital	5 000	
Retained profit	3 100	
		8 100

This column identifies the *value* of individual items

This column identifies the *total value* of individual items

The total fixed assets are $500 + 2000 = 2500$

Total of current assets

Total of current liabilities

Net current assets = current assets – current liabilities
 $6600 - 1000 = 5600$

Owners funds
 = owners capital + net profit for the year
 $= 5000 + 3100 = 8100$

This figure will be reduced if the owner takes money out of the business to pay themselves a salary. It would be shown as 'drawings'

A statement of financial position is a financial snapshot of the assets and liabilities of an enterprise on a particular day, usually the last day of the enterprises financial year.

Purpose of a financial statement of position

This shows:

- The value of all the enterprises assets and liabilities
- The source of capital used by the enterprise to finance its operations

Preparing a statement of financial position

To prepare a statement of financial position correctly, you first need to categorise the enterprises assets into fixed and current assets and liabilities into current and long-term liabilities.

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Information in the statement of financial position

Current liabilities: Debts that need to be repaid within one year

Capital: Shareholders funds or retained profit

Fixed assets: Assets not easily converted into cash

Current assets: Assets easily converted into cash



Total assets owned by the enterprise (fixed assets + current assets)

Long-term liabilities: Debts that have to be paid over more than a year

Total liabilities owed by the enterprise (current liabilities + long-term liabilities)

Can the enterprise pay its short-term liabilities?

What to look for – calculate the new current assets (current assets – current liabilities)

What it means – if the net current assets figure is negative the business may not have enough cash to pay its long term debts.

Possible actions to take – increase sales, reduce credit terms to customers, sell off fixed assets, reduce expenses.

Can the enterprise take a long-term loan to help grow the business?

What to look for – the figure for long term liabilities

What it means – if long-term liabilities are large, the business may find it difficult to get additional business finance.

Possible actions to take – sell of fixed assets or use cash to pay off some long-term loans.

What is the value of debtors?

What to look for – debtors in current assets

What it means – if the figure is large compare with other current assets, there may be a risk that some customers will not pay the money they owe to the business.

Possible actions to take – reduce the amount of trade credit provided to new customers; chase up customers who owe money.

Has the enterprise made a profit?

What to look for – the figure retained profit

What it means – compare the figure with the retained profit from the previous year – has it increased or decreased?

Possible actions to take – increase sales, reduce the cost of sales, reduce expenses.

Statement of financial position

B6

You can find a lot of information about the enterprise in the statement of financial position. The information can be analysed to understand the enterprises performance. From this, you can make suggestions to advise the enterprise on the actions it may need to take.



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- **Learning Aim B** : Financial records

Profitability and profitability ratios

B7

What is profitability?

Profitability is the ability of an enterprise to turn revenue into profit. This is known as its **profit margin**. It is the amount of profit generated from each £1 generated in sales revenue. So, a profit margin of 20% means the enterprise is generating £0.20 from each £1 of sales revenue.



Increasing profitability

An enterprise can increase its profitability by raising prices without demand falling or lower its costs without a noticeable change to the product or service.

Sales revenue and gross profit are the two items needed to calculate gross profit margin.



	£	£
Sales revenue		17 800
Cost of sales		7 120
Gross profit		10 680
<i>Less expenses</i>		
Wages	3 420	
Rent	1 400	
Marketing	600	
Insurance	1 700	
	7120	
Net profit		3 560

The value for sales revenue (17,800) minus the cost of these sales (7,120) will enable the business to calculate its gross profit.

The value for gross profit (10,680) minus total expenses (7,120) will enable the business to calculate its new profit (3,560).

Gross profit margin

To calculate gross profit margin, you will need to extract figures from the enterprises statement of comprehensive income.

Formula

Gross profit margin = (gross profit ÷ sales revenue) x 100
The answer will be shown as a percentage

Net profit margin

To calculate net profit margin, you will need to extract figures from the enterprises statement of comprehensive income.

Formula

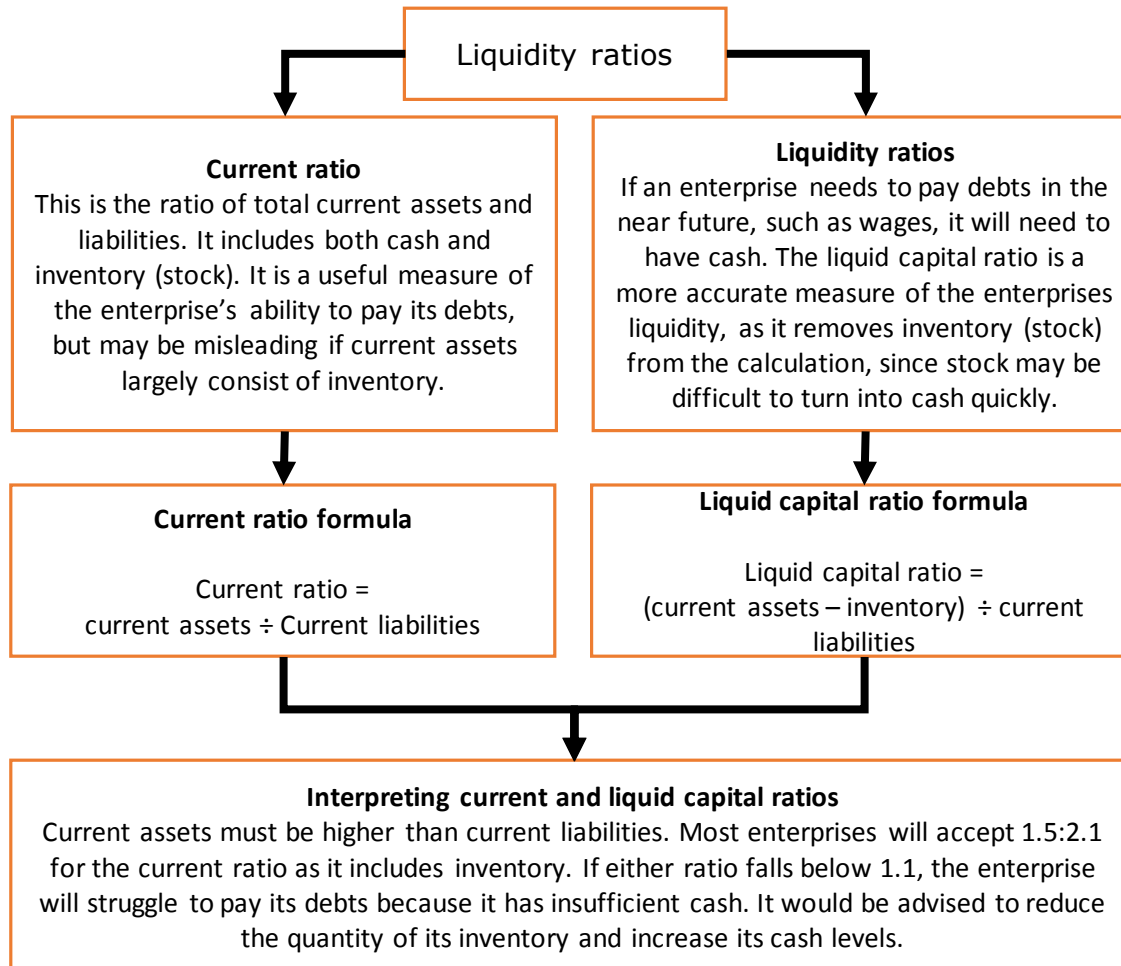
Net profit margin = (net profit ÷ sales revenue) x 100
The answer will be shown as a percentage

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- **Learning Aim B** : Financial records

Current ratio and liquid capital ratio

To understand the liquidity of an enterprise two ratios are calculated – one which *includes* the inventory (stock) and another which *excludes* it.



Liquidity and liquidity ratios

B7

Liquidity is the ability of an enterprise to pay its debts

- ✓ An enterprise with good (positive) liquidity will have sufficient net current assets to pay its creditors. It means the enterprise is **solvent** – can pay its debts.
- X An enterprise with poor (negative) liquidity may not be able to pay its debts. The enterprise may become insolvent and have to cease trading.

Liquidity and cash

If an enterprise needs to pay its debts in the near future – such as wages and heating and lighting – it will need to have access to cash.

The ability of an enterprise to convert its assets into cash is known as liquidity. For example, if a business has to pay its suppliers £5000 in 10 days' time but only has £2000 in cash, it could sell one of its fixed assets, such as a company vehicle it no longer requires, or sell some of its inventory (stock) at reduced prices.

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- **Learning aim C** : Financial planning and forecasting

Using cash flow data

C1



Inflow is the money coming into an enterprise.

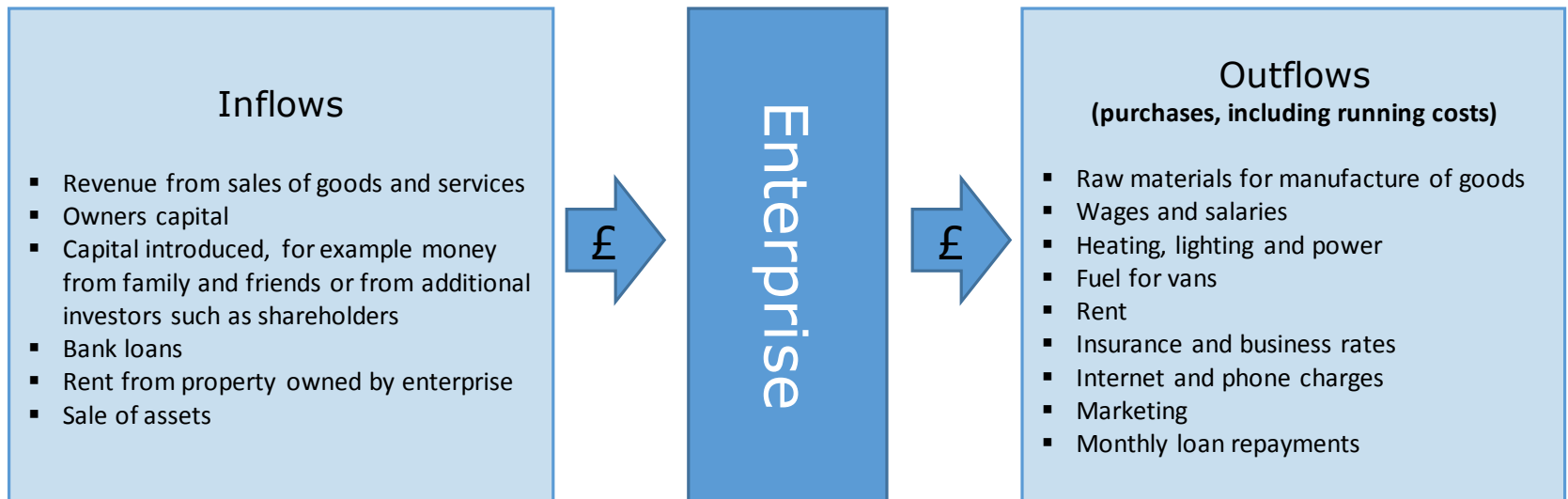
Cash in enterprise

Outflow is the money leaving an enterprise.

Cash inflows and outflows

Payments from customers are cash inflows. When an enterprise pays a bill, this is an example of a cash outflow. The difference between inflows and outflows is the amount of cash in the enterprise – this is its **net cash flow**.

An enterprise needs to know how much cash is flowing in and out, and its net cash flow, so that it can ensure it has sufficient money to cover purchases and other running costs such as wages, rent and any monthly loan repayments.



COMPONENT 3 – Promotion and Finance

- **Learning aim C** : Financial planning and forecasting

Enterprises collect cash flow data and use it to produce **cash flow statements** and **cash flow forecasts**. They use this information to monitor and control cash flow.

Cash flow statement

This records the enterprise's actual cash inflows and outflows over the previous 12 months. It is used by the enterprise to monitor the flow of cash. Analysis of the previous year's cash flow statement may be used to produce the enterprise's cash flow forecast.

Using cash flow data (cash flow forecasts) **C1**

Cash flow forecast

This predicts the enterprise's likely cash inflows from sales, and outflows (purchases) each month over a period of time. The forecast allows the enterprise to calculate net cash flow and ensure it has sufficient cash to cover its running costs.

It is also used to determine net current asset requirements – the working capital needed to operate the business – and to make business decisions.

The total receipts row shows the **cash inflows** (sales) for each month. In January, total receipts = £1000 + £250 = £1250

The total payments row shows the **cash outflows** (purchases) for each month. In January, total payments = £750 + £200 + £150 + £300 = £1400

This is a *negative* net cash flow (shown in brackets) where total payments are greater than total receipts.

The closing balance at the end of the month is calculated by adding together the net cash flow and the opening balance.

2019	Jan (£)	Feb (£)	March (£)
Cash inflows			
Sandwich sales	1 000	2 500	3 000
Soft drinks	250	750	1 000
Business loan			2 000
Total receipts	1250	3250	6 000
Cash outflows			
Bread and Rolls	750	900	1 120
Fillings	200	250	300
Soft drinks	150	225	400
Rent	300	300	300
Total payments	1 400	1 675	2 120
Net inflow/ outflow	(150)	1 575	3 880
Opening balance	2 500	2 100	3 675
Closing balance	2 100	3 675	7 555

The **net inflow/outflow** – the **net cash flow** – figure is calculated as total receipts (cash inflows) less total payments (cash outflows). In February, there is a net cash flow figure of £1575 (£3250-£1675).

The **closing balance** in one month is the money available to the enterprise at the end of the month. The closing balance is carried forward to the next month and becomes the **opening balance**. At the end of February, the closing balance was £3675. this was carried forward to become the opening balance in March.

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Financial forecasting

C2

- **Learning aim C** : Financial planning and forecasting

Analysis of cash flow information

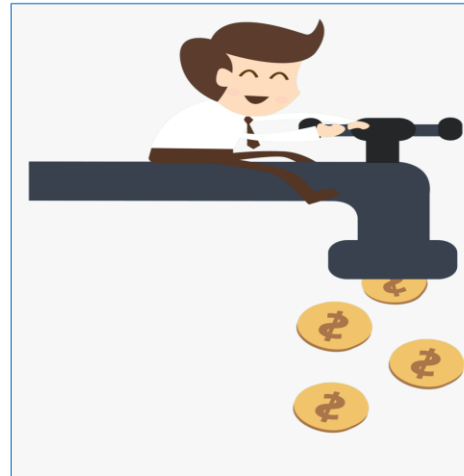
The differences between forecast and actual cash flow can alert an enterprise to cash flow problems. Cash flow information can be analysed to find out where there is a problem – in inflows or outflows. The size of the closing balance will indicate to the enterprise that it may need to take action to improve cash flow.

Total receipts (cash inflows) show a large increase between February and March, mainly due to the £2000 bank loan.

The closing balance forecast for April is only £230 as a result of the impact of the net cash outflow. If there is another cash outflow in May, Colin will need to take steps to improve cash flow.

Analysing the cash flow for Colins Bike Repair Shop:

2019	Jan (£)	Feb (£)	March (£)
Cash inflows			
Repairs	2 500	3 000	3 500
Spare part sales	950	1 000	1 300
Bank loan		2 000	
Total receipts	3 450	6 000	4 800
Cash outflows			
Cycle frames	1 900	2 120	2 400
Bike chains	750	1 900	2 200
Tyres	225	800	1 000
Rent	300	300	1 000
Loan repayment			75
Total payments	3 175	5 120	6 675
Net inflow/ outflow	275	880	(1 425)
Opening balance	500	775	1 655
Closing balance	775	1 655	230



Rent increased in April from £300 to £1000 per month. The enterprise may have moved to larger premises.

Monthly loan repayments start in April because the enterprise borrowed the money in March.

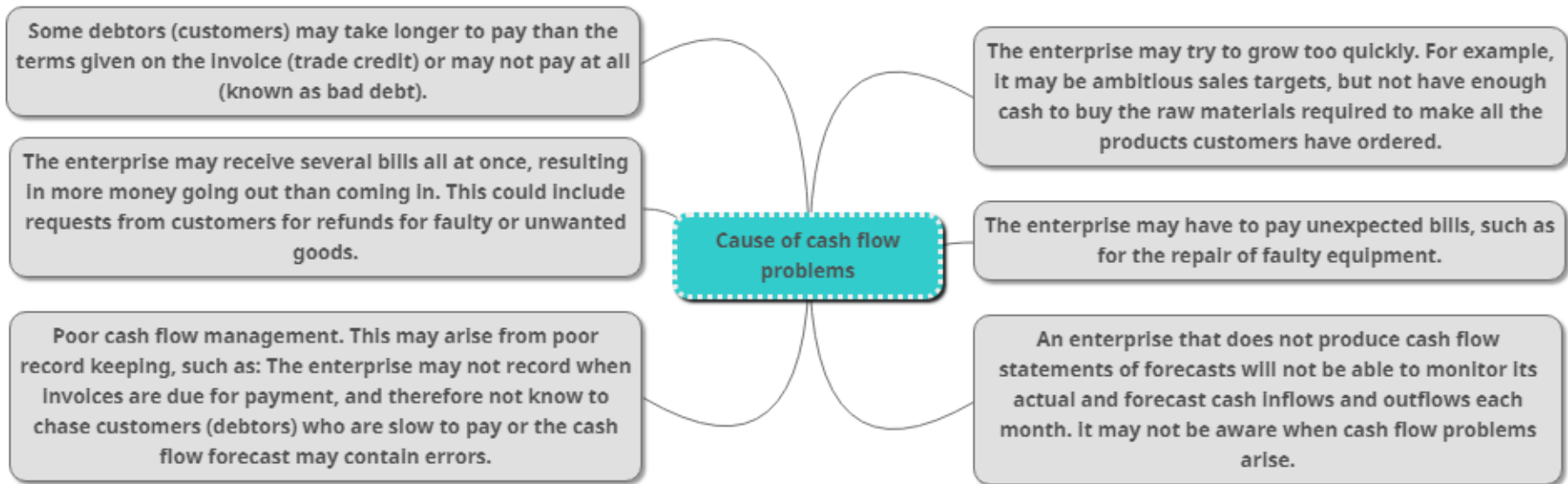
There is a negative net cash outflow in April of £1425. a move to larger premises (the big increase in rent) may mean the enterprise needs additional inventory (stock). Colin must ensure that cash inflows in future months increase, otherwise the business may face financial difficulties.

COMPONENT 3 – Promotion and Finance

- **Learning aim C** : Financial planning and forecasting

Suggesting improvements to cash flow problems

C3



Benefits of cash flow forecasting

- ✓ Timing of cash inflows and outflows is known
- ✓ Potential problems can be spotted quickly
- ✓ The purchase of expensive items can be planned to suit cash flow.
- ✓ The enterprise can plan when to expand or reduce its activities depending on cash flow.

Risks of not forecasting cash flow

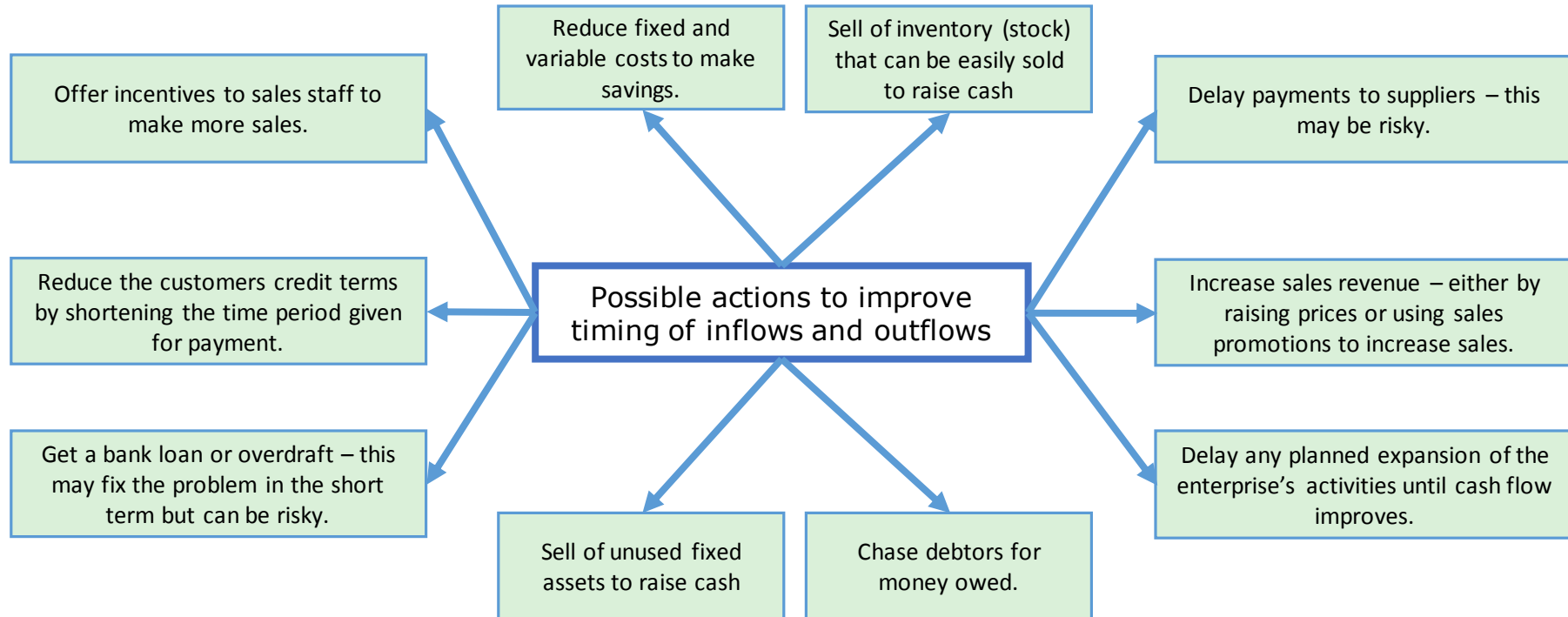
- X Late inflows (debtors) can be identified
- X There may not be enough cash to pay employees, suppliers and running costs
- X Suppliers may refuse to trade with an enterprise that does not pay on time
- X The enterprise may need an expensive loan or overdraft to cover short-term cash flow problems
- X The enterprise may run out of money and have to cease trading.

COMPONENT 3 – Promotion and Finance

- **Learning aim C** : Financial planning and forecasting

Suggesting improvements to cash flow problems

C3



Potential impacts of improving cash flow

- X **Reducing customers credit terms** may result in fewer sales if customers switch to other businesses that offer more favourable credit terms
- X **Selling off inventory** could be at a lower cost than the purchase cost, resulting in a financial loss.
- X **Selling off unused fixed assets** such as machinery or company cars may mean that the enterprise is willing to accept a lower price for these assets than they are worth.
- X **Delaying planned expansion** could mean that the enterprise is not able to take advantage of business opportunities.
- X **Reducing costs** by purchasing cheaper supplies or laying off part of the workforce could result in poorer quality products and dissatisfied customers.

COMPONENT 3 – Promotion and Finance

- **Learning aim C** : Financial planning and forecasting

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

C4

Break-even analysis and Break-even point

Break even

Break-even is when revenue from sales and costs are the same. There is no profit and no loss. At this point, the money that the enterprise has made selling a product is equal to the cost of making the product. The break-even point can be calculated using a formula.

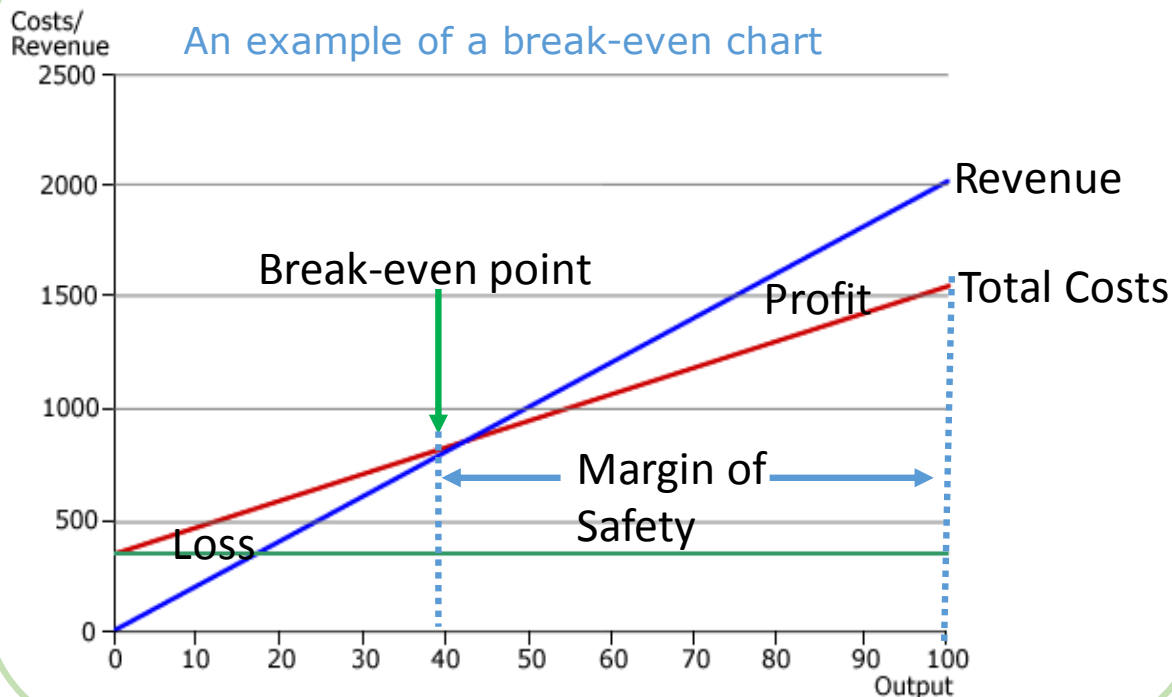


COMPONENT 3 – Promotion and Finance

- **Learning aim C** : Financial planning and forecasting

C4

Break-even analysis and Break-even point



Information for a break even chart:
Before drawing a break-even chart, you will need the following information about the product:

- Fixed costs
- Variable costs
- Total revenue (sales)
- Selling price per unit

How to draw a break even chart

1. Draw the **fixed costs** line
2. Draw the **total costs** line (variable + fixed costs)
3. Draw the **total revenue** line
4. Mark on the **break-even** point – where total costs and total revenue lines cross.

Remember to:

- Give the chart a title
- Label the axes, lines and break-even point



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

Key Facts



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

COMPONENT 3 – Promotion and Finance

- **Learning aim C** : Financial planning and forecasting

Using break-even analysis in planning

C4

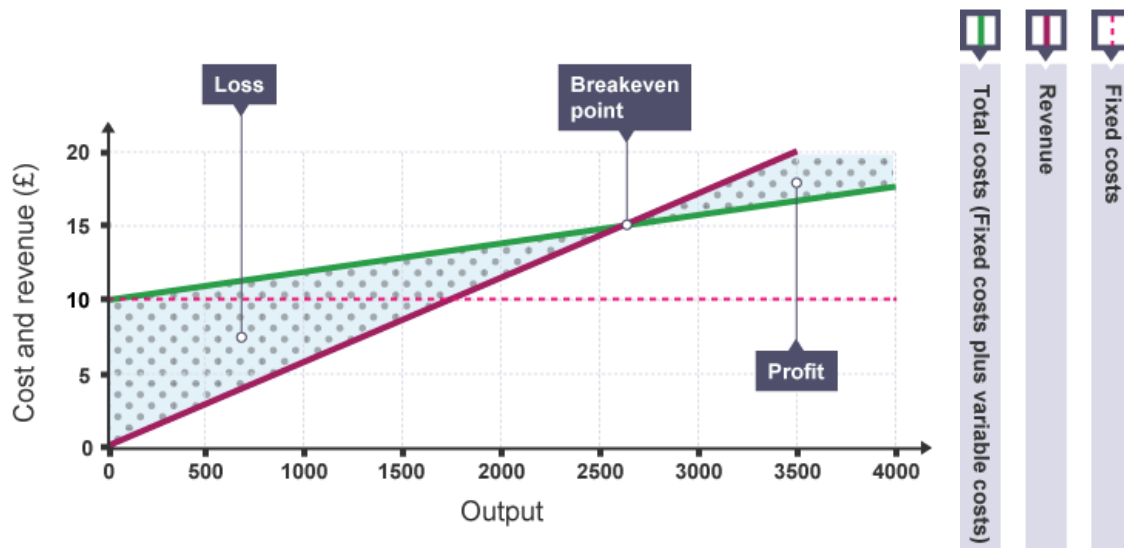
	Costs	Selling price	Sales (revenue)
	Costs fall Lowers break-even point. The enterprise makes more profit. The lower the break-even point, the fewer the sales are required to break-even.	Increase in selling price Break-even point lowers. Fewer sales required to break-even.	Sales increase Lowers break-even point. The margin of safety increases, revenue increases and the enterprise makes more profit.
	Costs increase Break-even point rises. The enterprise makes less profit. <i>Action to take:</i> the enterprise may need to sell more items to break-even. It may try to reduce costs. It may raise the selling price.	Decrease in selling price Break-even point rises. <i>Action to take:</i> The enterprise will need to make more sales to break even or reduce its variable costs.	Sales fall Break-even point rises. The margin of safety decreases. <i>Action to take:</i> The enterprise may try to improve sales by lowering the selling price. This increases the number of goods needed to be sold to break even. It may also reduce its variable costs.

Increasing the selling price.

A change in the selling price can have the opposite effect to the one hoped for by the enterprise – to lower the break-even point. Customer may not be prepared to pay the increased price and switch to a rival, cheaper brand.

Falling sales

An enterprise may lower the price for a short time only to boost sales and attract new customers.

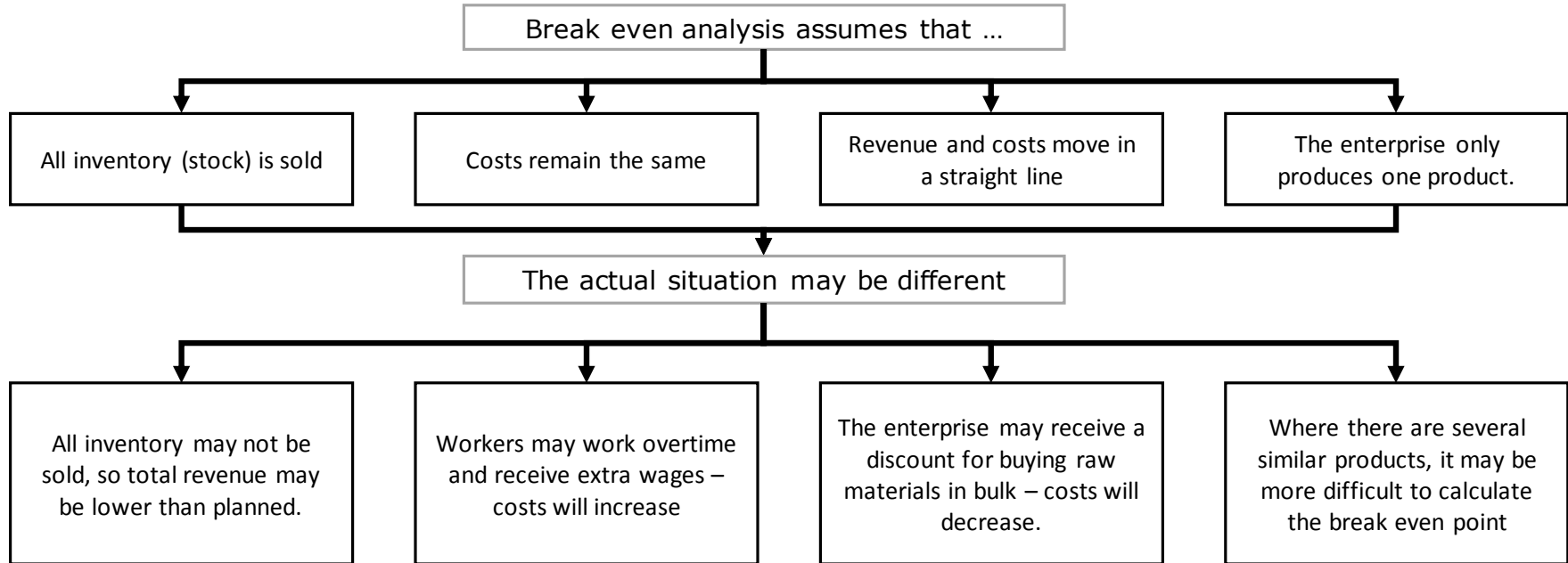


COMPONENT 3 – Promotion and Finance

- **Learning aim C** : Financial planning and forecasting

Limitations of break-even analysis

C4



Benefits of break-even analysis

- Fixed and variable costs are known
- Potential sales revenue can be calculated
- The number of items needed to be sold in order to make profit is known
- The enterprise can take action to increase profit, for example by reducing costs
- The best price can be set for the product
- The enterprise knows which are the most profitable products to make
- The margin of safety is known.

Risks of not using break-even analysis.

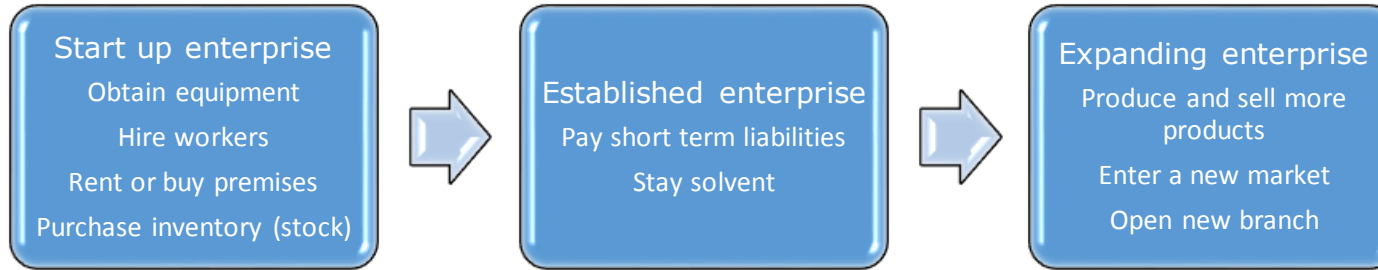
- Costs are unknown so action cannot be taken to reduce them if they are too high. For example if inventory (stock) is sold below cost price, the enterprise will make a loss.
- The enterprise will not know how many items need to be sold in order to make a profit. If it sells too few, it may make a loss.
- Setting the price of products may be guesswork, resulting in too high or too low a price.
- The margin of safety is not known.

COMPONENT 3 – Promotion and Finance

- **Learning aim C** : Financial planning and forecasting

Internal Sources of business finance

C5



Internal sources of finance

When an enterprise requires money, depending on the purpose, it may be able to provide the finance itself from its own finances.

Owner funds

Most new owners supply most of the start-up capital themselves because profits have yet to be made.

- ✓ No interest is payable
- ✓ If the enterprise is successful, the owner may in time get back their investment with a profit
- X The owner may not have sufficient savings to invest in the enterprise
- X If the enterprise fails, the owner may lose their investment

Retained profits

These can be used to finance the growth of the enterprise.

- ✓ Money does not have to be repaid and no interest is payable.
- X New enterprise will not be at the stage to have retained profits
- X Many enterprises may not make sufficient profits to be able to invest them back into the business.

Sale of assets

Vehicles, premises owned by the enterprise, machinery and equipment can be sold to give the enterprise cash to pay short-term liabilities, to address cash flow problems or to reinvest in the enterprise

- ✓ A good way to raise money from assets that are no longer needed
- ✓ It may avoid the need for a loan
- X Some enterprises may not have assets that they can sell. It may take time to sell larger assets.

Net current assets

This is money that is immediately available to the enterprise – its working capital. It may use this to pay short-term liabilities such as money owed to suppliers.

- ✓ A quick way to raise money
- X If selling off inventory (stock), the enterprise may have to accept a lower selling price.

COMPONENT 3 – Promotion and Finance

- **Learning aim C** : Financial planning and forecasting

External sources of finance – Short term

Bank overdrafts

The bank allows the enterprise to spend more than it has in its bank balance up to an agreed limit. This is a type of loan, and may be used by start-ups and small businesses.

- | | |
|--|--|
| <ul style="list-style-type: none"> ✓ Flexible method of finance as the enterprise only uses the overdraft facility when it needs to. ✓ Can be arranged quickly | <ul style="list-style-type: none"> X Interest may be at a high rate X Has to be paid in a short amount of time |
|--|--|

Credit cards

A common method of finance used by large and small enterprises. It can be used to purchase stock and finance business trips and pay hotel bills.

- | | |
|--|--|
| <ul style="list-style-type: none"> ✓ Instant source of finance ✓ Allows purchases to be made on behalf of the enterprise | <ul style="list-style-type: none"> X Interest can be high if not repaid in interest free period X Only suitable for purchases up to a credit limit |
|--|--|

Trade credit

Current assets are purchased on credit with payment terms of 30-90 days. Trade credit is often used by enterprises to buy raw materials or products to sell on.

- | | |
|---|---|
| <ul style="list-style-type: none"> ✓ Good for cash flow. In some cases, the enterprise may be able to sell on the products before paying the supplier for them. ✓ No interest is paid | <ul style="list-style-type: none"> X Can only be used to buy certain types of goods X Loan is only available based on supplier payment terms. |
|---|---|

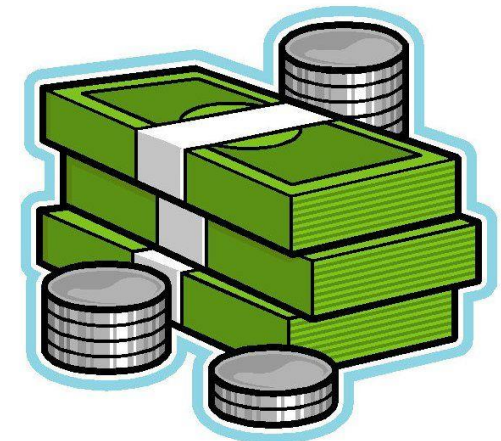
Sources of business finance

C5

Short term finance

Short term finance refers to financing needs for a small period normally less than a year. In businesses, it is also known as working capital financing.

This type of financing is normally needed because of uneven flow of cash into the business, the seasonal pattern of business, etc.



COMPONENT 3 – Promotion and Finance

- **Learning aim C** : Financial planning and forecasting

External sources of finance – Long term

Hire purchase

This allows the enterprise to purchase an asset such as equipment or machinery by paying a deposit followed by regular monthly instalments over a period of time.

- | | |
|---|--|
| ✓ Once the enterprise has paid all the instalments, it owns the asset | X It is more expensive method of purchase than buying the asset with cash at the outset. |
|---|--|

Bank loans

This is money borrowed by the enterprise at an agreed rate of interest. It is paid back over a period of time, for example 3,5,10 years. Bank loans may be used to purchase non-current assets such as vehicles, machinery or property.

- | | |
|--|---|
| ✓ The interest rate on the loan is fixed during the repayment period even if general interest rates increase | X Interest rates may be high and the bank may want security on the loan. |
| ✓ Enterprises can budget more easily as it is a fixed cost | X Failure to repay the loan may lead to the enterprise becoming bankrupt. |
| ✓ The rate of interest is usually lower than an overdraft. | |

Government grants

Local and national government grants are used to develop the economy. They may be given to certain enterprises, for example to enable them to create jobs in a certain area.

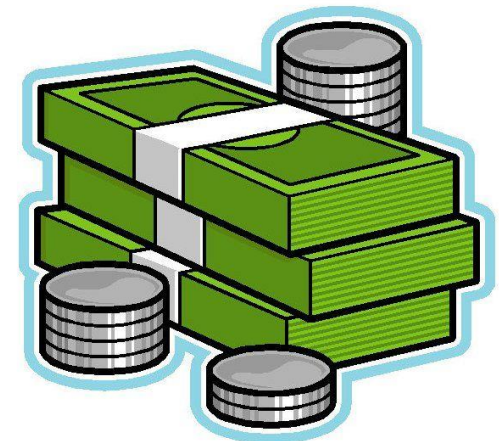
- | | |
|--------------------------------------|---|
| ✓ Grants do not need to be paid back | X Only certain enterprises are able to obtain government grants |
|--------------------------------------|---|

Sources of business finance

C5

Long term finance

Long-term finance can be defined as any finance with repayments exceeding one year (such as bank loans, bonds, leasing and other forms of debt finance)



COMPONENT 3 – Promotion and Finance

- **Learning aim C** : Financial planning and forecasting

External sources of finance – Long term

Leasing

This allows an enterprise to have use of the asset, such as an expensive item of equipment of machinery, over a period of time without buying it. The owner of the asset lends it to the enterprise for regular payments.

- | | |
|---|--|
| ✓ The enterprise can have modern equipment without having to pay out large amounts to buy them | X The enterprise does not own the asset. It returns the equipment to the owner at the end of the leasing period. |
| ✓ The enterprise has the asset it requires for the time it needs it. It is not left with an unwanted asset at the end of the leasing period | |

Venture capital

These are funds from a professional investor (venture capitalist) who expects a return on their investment and a share of the ownership of the enterprise.

- | | |
|---|---|
| ✓ The enterprise may benefit from the expert guidance of the venture capitalist | X The venture capitalist may want to be involved in decision making, and the enterprise owner may lose some management control. |
|---|---|

Peer-to-peer lending

Small investors invest in an enterprise, usually a start-up, in exchange for a return on their investment.

- | | |
|---|--|
| ✓ It may be used by enterprises that may have difficulty getting traditional forms of finance, such as a bank loan. | X Interest payments may be higher than traditional types of finance. |
|---|--|

Sources of business finance

C5

Long term finance

Long-term finance can be defined as any finance with repayments exceeding one year (such as bank loans, bonds, leasing and other forms of debt finance)

