Bottisham Village College

# KNOWLEDGE ORGANISER

## BUSINESS STUDIES

## YEAR 11 ALL YEAR

# KNOWLEDGE ORGANISERS

At Bottisham Village College, we are striving to create a five-year curriculum plan that builds effective revision strategies into homework and lessons, to ensure that students are able to place powerful knowledge into their long-term memories. Additionally, we hope that this will help build effective learning strategies from early in their time here at the college.

Based on evidence, we know that regular recall activities are the best way of achieving this goal and committing powerful knowledge into the students' memories.

At the start of each term, we shall publish all the knowledge organisers that students will require for their studies in each curriculum area. These will cover a range of aspects: facts, dates, characters, quotes, precise definitions and important vocabulary. We are clear: if this fundamental knowledge is secured, students can then develop their higher-level skills of analysis and critical understanding with greater depth.

They will be given an electronic A4 Knowledge Organiser (KO) booklet for each term containing all of the knowledge required. In lessons, Bottisham staff will be regularly testing this fundamental knowledge, using short-quizzes or even more formal "Faculty Knowledge Tests".

The best way to use these organisers at home, is to follow a simple mantra:

**1. Look at a certain aspects of a particular knowledge organiser**

**2. Cover up part of their knowledge organiser**

**3. Write it out from memory**

**4. Check and correct any spelling mistakes, missing bits or mistakes**

**So simple but so effective.**

**AQA Business Studies Revision Year 11 Term 1**

**Paper 1 Operations – 3.3.1 Production Processes and 3.3.2 Procurement**

## Subject Specific Vocabulary

- **Production –** takes the inputs of raw materials and labour to make the finished good or service.
- **Job production –** making one product at a time, to a customer's requirements. Items are unique. E.g. garden design
- **Flow production –** making products on a continuous production line moving from one stage of the process to the next. Assembly line (with robots) may run 24/7 with workers organised by shift.
- **Specialisation** – when individuals focus on one task on the production line.
- **Lean production –** approach to production that keeps waste to a minimum/maximum efficiency.
- **Kaizen –** Japanese for 'continuous improvement'. An approach to production which aims to make change in a business by making small changes/steps.
- **JIT (Just in time) production** – holds as little stock as possible. Items are ordered just in time to be used. Producing to order.
- **JIC (Just in case) production** – involves holding some stock should something unexpected happen e.g. demand increases. Buffer stocks are held therefore.
- **Purchasing economies of scale** – buying in bulk so that unit cost falls.
- **Procurement** – involves choosing and buying supplies.
- **Supply chain** – the group of businesses involved in the provision of raw materials and the production of the finished good for the customer – suppliers, manufacturers, distributors, retailers etc.
- **Logistics** – moving goods or services from a part of the supply chain to another.

## KQ – 6 Key Questions for this Topic

### KQ1 – What are the benefits and drawbacks of job production?

| Benefits | Drawbacks |
|---|---|
| High quality products.<br>More satisfaction from the workers who are more motivated. | Expensive, highly skilled labour required.<br>Labour intensive.<br>Long time to make. |

### KQ2 – What are the benefits and drawbacks of flow production?

| Benefits | Drawbacks |
|---|---|
| Identical products.<br>Take advantage of economies of scale.<br>Lower unit costs which can lead to competitive prices.<br>Can produce high output | Capital-intensive – expensive machinery needed.<br>Potentially a risky investment.<br>Specialisation/division of labour staff – can be boring, high absenteeism, poor staff retention rate etc.<br>Space is often needed for the storage of raw materials and finished products.<br>Only appropriate for mass-market i.e. the business can sell a lot. |

### KQ3 – What are the benefits and drawbacks of JIT?

| Benefits | Drawbacks |
|---|---|
| Stock levels kept low – so no need to store products – reduces costs.<br>Only make goods if they are sold or can leave the factory straight away.<br>Computer systems order more stock when it is needed – less need for staff employed to check stock levels. | A lot of coordination between the firm and its suppliers.<br>Lots of deliveries of small levels of stock – more costly as less likely to be able to take advantage of economies of scale and the cost of deliveries will be high too.<br>Frequent deliveries – greater chance of mistakes. |

### KQ4 – What are the benefits and drawbacks of JIC?

| Benefits | Drawbacks |
|---|---|
| Buffer stocks designed to cope with a supply shortage or if demand from customers increase. | Some stockpiling of items which can be costly to store. |

### KQ5 – What factors are considered when choosing suppliers?

- The cost of the supplies
- The speed of delivery (and again cost)
- Quality of the supplies
- Reliability – quantity and at the correct time

### KQ6 – What are the benefits of an effective procurement and logistics system for a business?

- Reduced overall costs – as supplies are agreed at the best price. These savings can be passed on to customers as lower prices.
- A good relationship with suppliers who will be loyal.
- Reduced waste and production more streamlined as supplies are delivered when they are needed.

**It is important to work with staff when using lean production. Kaizen requires the staff to come up with ideas for improvement and they are needed to check quality. As there is no finished stock to rely upon, a strike by disgruntled staff would be hugely damaging. Therefore, it is very important staff and management work together to achieve lean production.**

AQA Business Studies Revision Year 11 Term 1

**Paper 1 Operations – 3.3.3 Quality and 3.3.4 Customer Service**

**Subject Specific Vocabulary**

**Quality –** decided by the customer and is to what extent they are happy with a product or service.

**Total Quality Management –** a type of quality management that tries to eliminate errors throughout the production process. A product should not leave a section of the production process without the quality being checked. Everyone is responsible.

**Customer service –** when the business meets customers' expectations.

**Customer loyalty –** when customers buy only from that business, deciding they like their products/service more than their competitors'.

**KQ – 9 Key Questions for this Topic**

**KQ1 – How are quality issues identified?**

- By asking customers – surveys, feedback on social media, number of customer complaints
- Secret/mystery shoppers – gives an outsider's view but it is not popular with employees.
- By asking staff to be involved in quality management e.g. TQM

**KQ2 – What are the costs of poor quality?**

- Unhappy staff
- Cost of replacing goods
- Cost of waste
- Cost of recalling faulty products
- Cost of legal action if the business is sued

**KQ3 – How can businesses maintain/improve quality?**

- Use quality suppliers
- Invest in correct machinery to produce quality goods
- Train staff so they feel confident in their jobs
- Use a quality control/management/assurance system which inspects goods/services e.g. TQM
- Ask staff for their ideas on how to improve/detect problems (Kaizen)

**KQ4: What is meant by TQM?**

- Quality is the responsibility of every employee.
- Emphasis is on getting things right the first time
- Reduces costs generated by waste.
- Emphasis also on after-sales service.
- But it can take a while to implement, staff need training and it is often seen as extra work.

**KQ5 – What are the costs and benefits of maintaining quality?**

| Costs | Benefits |
|---|---|
| Including an inspection/checking system i.e. quality control or management.<br>Training staff.<br>Quality supplies are often more costly. | Customer loyalty.<br>Word of mouth between customers and potential customers.<br>Cost saving in many ways – see earlier question.<br>Charge more for a quality product/service.<br>Reputation improves. |

**KQ6 – How can good customer service be delivered?**

- Ensuring the product is safe and reliable
- Engaging with customers to find out what they want – assessing their needs. Sales person needs to be polite, friendly, genuine, make the customer feel important e.g. offering next-day delivery.
- Providing excellent product knowledge (written info as well as staff knowledge). Confidence in the sales person may encourage customers to make a purchase.
- Providing an after-sales service e.g. user training, helpline or following up with offering servicing e.g. boiler. Could also be an after-sale follow up conversation to check the customer is happy.
- Operating from well-maintained premises with provision for all e.g. disabled customers, family-friendly etc.
- Delivering goods on time.
- Allowing different methods of payment.

**KQ7 – What are the benefits of good customer service?**

- High levels of customer satisfaction
- Therefore loyal customers make repeat purchases
- Positive word of mouth
- Customers may spend more with a company they trust.

**KQ8 – Why does poor customer service occur?**

- Dissatisfied customers
- Negative word of mouth which spreads quickly, perhaps by social media.
- Poor reputation and falling revenue.

**KQ9 – How can ICT be used to improve customer service?**

- Websites can offer 24 hour ordering, easier to order, FAQ sections, live chat, online accounts that may encourage customers to buy.
- Social media can be used to communicate with customers, inform about new offers or changing opening times, makes contact quicker and easier. Complaints have to be dealt with quickly and politely to maintain a positive image.

# AQA Business Studies Revsion – Year 11 Term 1

## Paper 2 Marketing 3.5.1 Identifying and Understanding Customers

### Subject Specific Vocabulary

**Need –** good or service sold by a business which is needed for survival.

**Want –** good or service which is sold by a business which is desired by the customer and not essential for survival.

**Customer –** person who buys the good or service.

**Consumer –** person who uses the good or service.

### KQ – 1 Key Question for this Topic

**KQ1 – Why do businesses identify customer needs?**

- So customers will buy their goods/services
- To increase sales
- To select the correct marketing mix
- To avoid costly mistakes
- To be competitive

## Paper 2 Marketing 3.5.2 Segmentation

### Subject Specific Vocabulary

**Sales volume –** the number sold

**Sales value –** the total revenue generated

**Segmentation –** dividing the market into groups, based on needs and wants.

### KQ – 3 Key Question for This Topic

**KQ1 – What are the benefits of market segmentation?**

- Products are developed closely to customer needs e.g. family sized cars
- Targeting of customers more precisely e.g. people who watch sport on tv, may also bet on websites. So betting agencies advertise in the adverts between sporting events.
- Set prices appropriately. If there is a gap in the market in ethical shoes, a business can charge more.

**KQ2 – How can the market be segmented?**

- **By gender –** chocolate manufacturers target their products at different genders e.g. Yorkie for men. Flake for women.
- **By age –** e.g. Saga sell holidays to the over 50 year olds.
- **By location –** food businesses may have different recipes according to where they are in the world as people eat different types of food in different parts of the world.
- **By income –** high income earners will have different products offered to them than low income earners. Supermarkets often have a 'basic' range and a 'luxury' range.
- **By stage in life cycle –** e.g. small cars are aimed at probationary drivers and larger cars are aimed at families.

**KQ3 – Why do businesses target segments?**

- To make money – some segments are more profitable than others
- To compete to control market share
- Because there is no other alternative.

## Paper 2 Marketing 3.5.3 Methods of Market Research

### Subject Specific Vocabulary

**Market research –** collecting information about the customers or competitors of a business, in order to make informed, relevant, marketing decisions.

**Quantitative data –** data in the form of numbers

**Qualitative data –** data in the form of opinions

**Primary data collection –** also called field data and is information collected for the first time.

**Secondary data collection –** also called desk data and this has been collected by someone else previously.

**Questionnaires –** questions in a document completed by the sample.

**Phone survey –** questions asked of people on the phone.

**Interviews –** face to face questioning.

**Focus groups –** like an interview but a group of people discuss a product or service (which they may have tested) to give their opinions.

**Sample –** the group of people chosen to be questioned from the total 'population'.

### KQ – 2 Key Questions for this Topic

**KQ1 – What are the advantages and disadvantages of primary market research?**

| Advantages | Disadvantages |
|---|---|
| Cheap – Q'naires<br>Large geographic area – Q'naires | People do not respond – Q'maires<br>Expensive – Interviews and Focus Groups<br>Quieter people may not respond – Focus Groups. |

**KQ2 – What are the advantages and disadvantages of secondary market research?**

| Examples: | Government publications, internet research |
|---|---|
| Advantages | Disadvantages |
| Cheaper, easily found, readily available, cheap | Not always directly relevant and can be out of date. |

**Paper 2 Marketing 3.5.4 Promotion and Place**

## Subject Specific Vocabulary

**Advertising –** messages paid for by the business to promote their products/services

**Sales promotions –** incentives to encourage customers to buy products/services.

**Promotional mix –** all the different promotion methods to communicate to a customer, used by a business.

**Distribution channel –** the route taken by the product from the producer to the customer.

**Intermediary –** any link in the distribution chain between the producer and the customer.

**Wholesalers –** these businesses buy from the producer in bulk. They break down the quantities into smaller bulks (i.e. they break bulk) and sell to retailers.

**Retailers –** businesses called shops that sell directly to customers.

**E-commerce –** online buying and selling.

**M commerce –** buying and selling using a mobile device e.g. a mobile telephone.

**Direct marketing –** when the producer communicates directly to the customer.

**Sponsorship –** when businesses give money to sporting events, schools, teams, tv shows, art galleries etc. on the understanding that their brand/company/logo is displayed.

## KQ – 8 Key Question for this Topic

### KQ1 – Why do businesses promote?

- Tell customers about a new product or remind them about an old one
- To persuade customers to buy the product
- To create or change the image of a product
- To increase sales leading to greater profit and more market share.

### KQ2 – What are the benefits and drawbacks of different forms of advertising?

| | Benefits | Drawbacks |
|---|---|---|
| **Newspapers** | Local - good for a specific areas. National – reach a wide audience. | Print quality often poor and readership is falling. |
| **Magazines** | Good for targeting specialist markets over a large area. Better quality than newspapers. | More expensive than newspapers. |
| **Posters/ Billboards** | Can be placed near a target audience. Seen daily and in position for a long time. | People become 'blind' to them and message has to be short, for people to read. |
| **Television** | Seen by a wide audience. Involves sounds and video. Can deliver long messages. | Very expensive. |
| **Leaflets/ Flyers/ Business cards** | Cheap and can be targeted to a certain area and people keep them until they are needed. | Often seen as junk mail and thrown in the recycling. |
| **Internet** | Can be seen anytime and can include sounds, long messages and videos. | People annoyed by pop ups. |

### KQ3 – What are the benefits and drawbacks of promotional methods used by businesses?

- **Sponsorship –** high profile for your business but bad publicity with the event/tv show etc. can reflect badly on your business
- **Public Relations –** i.e. communicating with the media. Good as it gets product/service recognised by a large audience relatively cheaply but difficult to control what the media says.
- **Sales promotions –** competitions, 2 for 1, free samples, coupons, point of sale displays and free gifts. Good as they encourage the customer to try the product and will boost sales in short term. However, customers might not buy once the offer ends, if too cheap a deal people may question quality.

**KQ4 How does a business decide what is the best promotional mix for their business?**

This will depend on …

- how much money the business has to spend on promotion
- the type of product or service.
- what competitors are doing
- nature of the market – growing or falling sales
- target market – young people use social media more than older people.

**KQ5 What are the benefits and drawbacks of using social media for promotion?**

| Benefits | Drawbacks |
|---|---|
| Quick, easy, cheap etc. Can be used for advertising, sales promotions, news stories. There can be links from social media pages to the firm's website. | Negative customer comments have to be managed carefully and quickly. Mistakes are public. Therefore posts have to be monitored very carefully. |

**KQ6: What types of distribution channels exist?**

- **Producer to wholesaler to retailer to customer** – good for manufactured goods where producer does not need to speak to the customer. Problem – long distribution channel, everyone wants to make a profit and customer service levels may be lower.
- **Producer to retailer to customer** – manufacturer can give retailer product knowledge so usually customer service is better. Retailer can promote product (point of sale displays), reaches lots of customers but relies on the producer being able to convince the retailer to stock their product.
- **Producer to customer** – cheapest way to distribute products. Time consuming as the products have to be distributed to all the individual customers. Good for small businesses with few customers. Examples – mail-order, telesales, m and e commerce.

**KQ7: What are the benefits and drawbacks of selling through E-commerce and M-Commerce?**

| Benefits | Drawbacks |
|---|---|
| Wider market available – global. More potential customers who can order at any time from home. Websites and apps mean that businesses no longer need printed brochures – cost saving. Cost saving again – do not need telephonists to take the orders, so redundancies have been possible. Cost saving – physical branches have been closed. | Greater competition – global. Easier for customers to compare products on websites so businesses have to work very hard to keep customers by offering free delivery, returns etc. May need to employ specialist web or app designers. Training may be necessary for some staff. Security of the site is vital – customers do not want their credit card details being used fraudulently. |
| Available to small businesses as cheaper than a physical store. More reliable than ever before – lower prices for customers, free delivery and returns often also offered. Customers expect to be able to buy online | Some reluctance to buy online by some customers for some goods. They may prefer to visit a shop and receive personal contact when making a purchase. Need to be able to manage the high rate of returns of goods. |

**KQ8: Why is it important to get the distribution channel correct?**

- Different distribution channels cost different amounts. Intermediaries e.g. wholesalers, usually put up prices for the customer.
- Some businesses will want their products displayed in a certain way – if the distribution to customers is handed over to a retailer, will they display the product as the producer would like it be displayed? Therefore image and control may be important.
- Customers are prepared to travel further for more expensive items. They will not be prepared to travel far for convenience goods. Therefore these need to be readily available to customers to ensure sales.

**Place is not just about where the product is sold. It is wider than that – it is about the availability of the product/service to customers.**

**Paper 2 Marketing 3.5.4 Pricing**

**Subject Specific Vocabulary**

**Price skimming –** high price when a product enters the market e.g. the latest iphone.

**Penetration pricing –** low price when a product is launched to achieve quick sales e.g. a new chocolate bar

**Competitive pricing –** using competitors' prices to decide your price.

**Loss leader –** product sold below cost price that attracts a customer who will the hopefully buy something else e.g. buying a pint of milk (loss leader) and at the same time buying a ready meal for dinner.

**Cost plus pricing –** products are priced to cover the cost to produce and then adding a % on top.

**Mark-up in cost plus pricing** – calculate the cost price and then add a % mark up. £10 product with a 25% mark up will be £10 + (25% of £10) = £12.50

**Using a profit margin with cost plus pricing** – calculate the cost price and then increase the price to the profit margin you want. £10 product with a 20% profit margin … £10 is 80%, 20% is £2.50, so product costs £10 + £2.50 and would be sold for £12.50.

**KQ – 2 Key Question for this Topic**

**KQ1 – What factors determine price?**

| Internal Factors i.e. controlled by the business | External Factors i.e. not controlled by the business |
|---|---|
| **Business aims and objectives.** If wanting to increase market share, prices may be dropped to increase sales. | **Nature of the market –** luxury item will be sold at a higher price. |
| **Internal costs may change.** New machinery may mean costs fall and therefore a business can charge lower prices to its customers. | **Competitors** – do not want the price to be very different from competitor's. Too high, customers buy from competitors. Too low, quality is questioned. |
| **Position in the product life cycle.** Introduction and growth phases – prices may be low or very high to encourage people to buy. Maturity – prices need to be competitive and in decline, prices need to be low. | **Raw material costs** – if these go up, the price of the product will have to go up. |
| **Promotional campaign – price may be reduced to accompany the campaign.** | **Demand** – high demand from customers could result in higher prices. Low demand – prices have to be lowered. Demand can be determined by how the economy is doing and the rate of employment. |

**KQ2 – What are the different pricing strategies?**

| Pricing strategy | When is it used? |
|---|---|
| **Price skimming** | High demand for a product.<br>Buyers not sensitive to price – willing to pay more.<br>Used by business to pay high development costs.<br>Works with a unique product |
| **Price penetration** | Low price to attract buyers<br>Used to grow market share of a new product/service<br>Little profit made to start with until market share established, then price increases.<br>Hoped that loyal customers will continue to buy with high price. |
| **Competitive pricing** | Used when there is lots of choice and products do not vary greatly.<br>Usually makes little profit. |
| **Cost plus pricing** | Used when not in direct competition with others. Cost price calculated and then extra is added on – either as a mark-up or as a profit margin. |
| **Loss leader** | No profit made as priced below cost price.<br>Hoped customers buy other products at the same time where a profit is made. |

## Paper 2 Finance 3.6.1 Sources of Finance

### Subject Specific Vocabulary

**Retained profits** – profit (Revenue – Total costs) that is not distributed but put back/invested in the business

**Share –** a portion of ownership in a business held by a shareholder. These are bought, which generates share capital for the business.

**Shareholder** – person who owns a portion of the business. The shareholder is entitled to a share of the profit, called dividends.

**Loan –** a long term source of money usually borrowed from a lender such as a bank. Both the amount borrowed and interest must be paid back.

**Mortgage –** a loan which can only be used to purchase property/premises for the business.

**Interest** – the charge issued by lenders to borrowers, when paying back a loan.

**Unwanted asset –** an item of value the business no longer wants/needs

**Overdraft** – when more money is taken out of a bank account that has been paid in. It is best to arrange an overdraft with your lender.

**Trade credit** – when businesses can buy materials from a supplier and they have a period of time (say 28 days) to pay their account.

**Hire purchase –** used to purchase equipment. A deposit is paid and then monthly instalments. The business has use of the equipment whilst they are buying it

**Government grant –** money given to businesses that does not have to be paid back.

### KQ – 5 Key Questions for this Topic

**KQ1 – Why do businesses need finance?**

- To start up
- To cover their running costs
- To expand
- To help with cash flow, when first starting up

**KQ2 – What are the main internal sources of finance along with their advantages?**

- **Personal (or business) savings –** usually the case when a small business sets up.
- **Retained profits –** profits put back into the business and have not been distributed to shareholders as dividends. Shareholders usually like profits to be distributed to them so there can be some conflict.
- **Selling assets –** items of value the business no longer needs e.g. old premises, vehicles or machinery. Have to make sure the business no longer needs the asset.

**KQ3 – What are the main external sources of finance with their advantages?**

- **Bank loans/overdrafts/mortgages –** paid back with interest and if not repaid, assets are claimed. Loans and mortgages usually have lower interest rates than overdrafts. Mortgages used for premises and the property is used as security/collateral. Sole trader may use their own home as collateral – they could lose their own home if they don't keep up repayments
- **Family and friend loans or your own savings –** money lent immediately, a good idea to draw up a contract as disagreements can arise.
- **New share issue –** limited companies can sell more shares. Money raised does not have to be paid back but more shares means less control and the new shareholders will want dividends.
- **Trade credit** – usually used to buy supplies, agreement gives a period of time to pay back the supplies taken. Same things as running an account.
- **Government grants –** usually available for small businesses, young entrepreneurs or in areas of high unemployment. Don't have to be paid back but not everyone qualifies. Can take time to organise. Often comes with business advice.
- **Hire purchase –** used for machinery. Deposit paid and then instalments. With last instalment, the machinery is owned by the business. Enables business to buy and use machinery that they couldn't normally afford.

**KQ4 – What is the most appropriate source of finance for different scenarios?**

- Invoice to a supplier – trade credit
- Premises – mortgage
- Buying a rival company – new share issue

**KQ5 – What factors affect the choice of finance?**

- Size of the business – small businesses may not have assets to sell
- Type of business – small business may not be able to get a loan, as they lack assets to offer as security to the lender
- Amount of money needed – family members may not be able to loan very much
- Length of time the finance is needed for – long term loan is not appropriate for paying a late bill
- Cost of the money – lenders offer loans at different interest rates e.g. overdraft – high interest rate, long term loan – lower interest rate, Bank of Mum and Dad – maybe nothing!

## Paper 2 Finance 3.6.2 Cash Flow

### Subject Specific Vocabulary

**Cash flow** – money that comes into a business and leaves, day to day.

**Cash Flow Forecast –** looking to the future, expected cash inflows and outflows over a period of time.

**Cash Flow Statement –** looking to the past, actual figures of inflows and outflows over a period of time.

**Cash inflow –** money in (receipts).

**Cash outflow –** money out (spending/payments).

**Profit** – the difference between revenue/sales and total costs.

**Opening balance** – the amount in the account at the beginning of the month.

**Closing balance** – the amount in the account at the end of the month.

**Net cash flow** – Calculated by total inflows – total outflows.

**Credit terms** – how long customers have to pay the business. Could also be the time the business has to pay suppliers.

**Working capital** – the money a business has to pay for expenses, to run their business.

**Creditors** – the people the business owes money to.

### KQ – 7 Key Questions for this Topic

**KQ1 – How does cash flow into a business?**

- Sales to customers
- Selling assets
- Loans from banks
- Other sources of finance e.g. personal savings when setting up the business.

**KQ2 – How does cash flow out of a business?**

- Buying raw materials/resources
- Wages and salaries
- Paying for the premises e.g. rent or mortgage
- Interest on loans
- Taxes to the government

**KQ3 – Why do businesses cash flow forecast?**

- To predict when there may be a lack of cash i.e. liquidity problem.
- To know when to organise an overdraft with the bank.
- To organise alternative sources of finance.

**KQ4 – How to interpret a cash flow forecast or statement?**

- 3 sections
- Cash inflows come first, cash outflows come next and then the third section shows the net cash flow, opening and closing balances.
- Cash inflows are all added together to get the total cash inflows. The same is true for the cash outflows
- The closing balance of the previous month, will be the opening balance of the next.
- The opening balance plus the net cash flow (whether this is a positive or a negative number) gives the closing balance.

**KQ5 – What are the consequences of cash flow problems?**

- Businesses do not have enough cash to run their business i.e. to pay day to day expenses. They lack working capital.
- Staff may not get paid – they will not be happy! They will become demotivated and over time, may look for other jobs, especially if they think the business is in financial difficulty.
- Discounts for early payment of bills with suppliers – businesses cannot take advantage.
- Creditors will not be happy – may have stricter credit terms in the future. Some may even take legal action to recover the debt.
- Bankruptcy

**KQ6 - What are the benefits of a positive cash flow?**

- Usually means the business has good sales
- Lenders like businesses that have positive cash flow – it is likely the business will be able to afford loan repayments.
- Happy staff if they are paid on time
- Suppliers are paid on time – so are also happy!

**KQ7 – What are the solutions to cash flow problems?**

- Rescheduling payments – making later payments to suppliers (organising trade credit), for example.
- Using the overdraft facility of the bank account
- Reducing cash outflows – finding cheaper suppliers
- Increasing cash inflows – encouraging customers to pay promptly or increasing their selling price

**Cash and profit are not the same thing. Cash is the money the business has access to in their bank account. Profit is the difference between sales and costs.**

## Paper 2 Finance 3.6.3 Financial Terms and Calculations

## Average Rate of Return

### Subject Specific Vocabulary

**Investment –** money put into a business to make itself more profitable.

**Average Annual Profit –** the mean of the profit (Sales minus total costs) per year.

**Average Rate of Return –** this is a calculation to help the business decide if the investment is worth the effort.

### KQ – 3 Key Questions for this Topic

### KQ1 – What can businesses invest in?

- New machinery – greater efficiency
- New buildings – for expansion
- New employees – for expansion
- Training employees – for efficiency
- New vehicles – for efficiency

There is always an element of risk – the business hopes the investment will bring in more money to the business. To help to decide if the investment is worthwhile, the business calculate the average rate of return.

### KQ2 – How do you calculate the average rate of return?

- The ARR is a calculation to find out if the investment will give the business enough back over the lifespan of the investment.
- First find the average annual profit – this may be a calculation in its own right. Add up the profit over the number of years (say 7 years) and then divide by the number of years. This will be your average annual profit for the investment.
- Then divide by the cost of the investment and multiply by 100.
- Formula is …

$$\text{ARR \%} = \frac{\text{average annual profit}}{\text{Initial investment}} \times 100$$

### KQ3 – How do businesses interpret the average rate of return figure?

- The higher the %, the greater the return on the investment
- Managers will choose the investment with the greater ARR %
- This means that different investments can be compared, to decide which would be the best to invest in.
- However, this calculation relies on forecast figures, so there is always a chance that the ARR may not be the actual rate of return.

## Paper 2 Finance 3.6.3 Financial Terms and Calculations

## Break Even

### Subject Specific Vocabulary

**Break even output –** the production level when a business's total costs and sales are equal. Neither a profit or a loss is made.

**Break even chart** – graph drawn to show the business's fixed costs, total costs, revenue etc so that the level of output needed to break even can be established.

**Margin of safety –** the amount by which a business's level of output exceeds its break even level of output.

**Fixed costs –** costs that stay the same regardless of output e.g. rent

**Variable costs** – costs that change according to output e.g. raw materials

**Revenue** – money achieved through sales

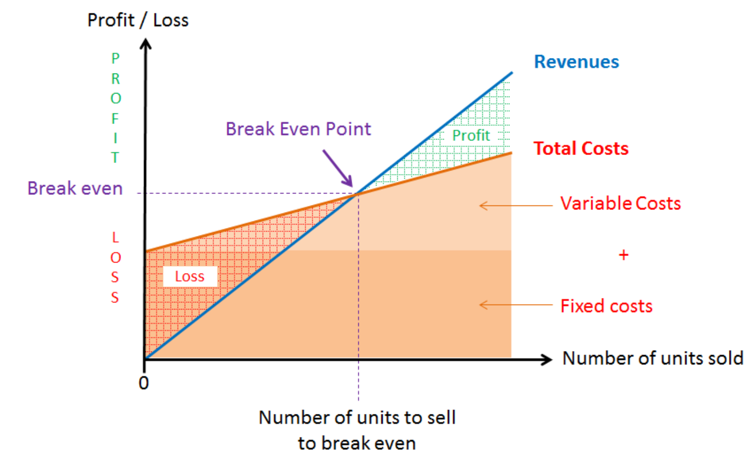
**Profit –** when sales exceed total costs

**Loss –** when total costs exceed sales.

### KQ – 2 Key Questions for this Topic

### KQ1 – How do you interpret a break even chart?

- Fixed costs are shown as a horizontal line as these do not vary with output
- Total costs are shown as a diagonal line reaching up from the horizontal fixed cost line.
- Revenue line is also diagonal, starting at 0.
- Where the revenue line crosses the total cost line, is the point of break even.
- Levels of output below this, means a loss is being made.
- Levels of output above this, means a profit is being made.




### KQ2 – What are the benefits and drawbacks of break even analysis?

| Advantages | Disadvantages |
| --- | --- |
| See easily the impact of rising costs, change in price and therefore revenue. | Assumes that businesses sell all of the output they produce – rarely the case. Constantly out of date as costs and prices change rapidly. |

**Paper 2 Finance 3.6.4 Analysing the financial performance of a business**

**KQ – Why do businesses prepare financial statements?**

- Legal requirement for companies under the Companies Acts in an agreed format – failure to do so means fines.
- Help with the decision making of managers – so that they know whether the business is more or less profitable than before. Whether it is worth more or less than before.
- Guide potential investors – see whether investing in the business is a good idea or not.
- Guide lenders such as banks

**Income statements/Profit and Loss Accounts**

**Subject Specific Vocabulary**

**Income statement –** a financial document that shows a business's revenue, costs, profit or loss over a period of time.

**Gross profit –** sales revenue minus costs of sales over a period of time, usually 1 year.

**Net profit –** sales revenue minus costs of sales and overheads over a period to time, usually 1 year.

**Gross profit margin** – gross profit divided by revenue and expressed as a percentage.

**Net profit margin** – net profit divided by revenue and expressed as a percentage.

**KQ – 4 Key Questions for this Topic**

**KQ1 – What does an income statement show?**

It sets out the revenue, costs and profit made by a business over the last 12 month, usually.

**KQ2 – What are the main components of an income statement?**

- **Revenue –** income received by a business in a yr
- **Cost of sales –** costs such as wages, buying stock and energy – needed to supply the good/service
- **Gross profit –** revenue minus the cost of sales
- **Overheads/Expenses –** costs that do not change with the level of production/output e.g. management salaries.
- **Net profit –** when all costs are deducted from revenue. Often thought of as the 'true' profit.

**KQ3 – How do businesses calculate GPM and NPM?**

$$GPM = \frac{\text{Gross Profit}}{\text{Revenue}} \times 100 \qquad NPM = \frac{\text{Net Profit}}{\text{Revenue}} \times 100$$

- GPM/NPM of 25% means that 25p in every £1 of sales is gross or net profit.
- NPM will always be lower than the GPM
- NPM is a good measure of the business's financial performance as it includes all costs

**KQ4 – How do you make judgements about a business based on their income statement?**

- GPM for one year needs to be compared with GPM of the previous year – is it now higher/lower? So is the business more or less profitable than previously? NPM too
- GPM could also be compared with the GPM of a competitor for the same time period. NPM too.
- GPM/NPM can also be compared with targets.
- NPM will give an indication of what has happened to expenses as well as costs of sales. GPM – just costs of sales.
- Profit figures can be improved by reducing costs, improving the number sold as well as raising prices.

**Paper 2 Finance 3.6.4 Analysing the financial performance of a business**

**Statement of Financial Position/Balance Sheets**

**Subject Specific Vocabulary**

**Balance sheet –** lists the assets and liabilities of a business on a particular day i.e. a snapshot.

**Assets** – items of value owned by the business.

**Liabilities –** money owed

**Total equity –** money owned by the shareholders i.e. asset value minus the liabilities

**KQ – 2 Key Questions for this Topic**

**KQ1 – What does a statement of financial position/balance sheet show?**

It sets out the assets and liabilities of the business, as well as showing where finance has come from. Ultimately it shows what the business is **worth.**

**KQ2 – What are the main components of a statement of financial position/balance sheet?**

- **Non current assets** – assets that would take a long time to turn into cash, should the need arise e.g. premises, machinery. Long term assets.
- **Current assets** – short-term assets which can be turned into cash quickly, usually in less than a year e.g. cash itself, stock.
- **Non current liabilities** – long term loans such as a mortgage
- **Current liabilities** – short-term debts which will be paid back within a year e.g. paying suppliers