Knowledge Organiser

Unit 5: Finance

5:1 The Role of the Finance Function

Finance function
is the finance department and is only found in larger businesses

It is vital for any business to have accurate financial data. Without accurate data wrong decisions could be made which affect the business negatively.

When will financial info be useful in business decision-making?	
When a business decides to become more environmentally friendly	There may be increased costs to monitor, it may need extra finance - finance function will provide this
When the business is thinking about changing production methods	A prediction in changes of costs will be needed from the finance function as well as what extra finance will be needed and how the changes might affect cash flow
When the business wants to change the way it markets its products	The finance department would provide information about the costs of these new advertising methods and may need to raise extra finance

Financial information
Includes details of profit, loss, cash flow, break-even, profit margin and average rate of return. These can be used to help make business decisions.

5:3 Revenue, Costs and Profit

	Calculation
Revenue	Quantity sold x selling price
Variable costs	Quantity sold x variable cost per unit
Total costs	Fixed costs + variable costs
Gross profit	Revenue - cost of sales
Net profit	Gross profit - expenses
Gross profit margin	Gross profit ÷ revenue x 100
Net profit margin	Net profit ÷ revenue x 100
Profit	Revenue - costs

Businesses will need to interpret these figures to help make business decisions

Revenue
Money from sales
Average rate of return
A method of measuring and comparing the profitability of an investment over its life
Loss
Occurs in a business when costs are greater than revenue
Expenses
The costs of operating the business
Profitability ratios
Calculations which help to interpret financial data

5:2 Sources of Finance

Owners' capital

Advantages	Disadvantages
▪ No need to repay the money ▪ No interest has to be paid ▪ No cost to raise the finance ▪ Readily available	▪ The owner might not have enough savings to cover the whole finance ▪ May leave the owner short in personal situations

Retained profit

Advantages	Disadvantages
▪ No interest has to be paid ▪ No need to repay the money ▪ No cost to raise the finance ▪ Readily available	▪ Business might not have enough profit to cover the whole finance ▪ May leave the business short in the future in emergency situations

Loan

Advantages	Disadvantages
▪ Repayment is spread over time ▪ Business knows exactly how much has to be repaid and when ▪ Money is available quickly	▪ Interest has to be paid ▪ Business may need to risk an asset as security ▪ Bank will want to see a business plan to ensure they can afford the loan

Issuing shares

Advantages	Disadvantages
▪ A lot of finance can be raised from many investors ▪ Money does not have to be paid back ▪ No interest is payable	▪ Dividends may have to be paid to shareholders ▪ Shareholders are entitled to have a say in the running of the business ▪ The business may be taken over by a competitor

Interest
The amount of money that has to be paid back on borrowed money
Sale of assets
Items sold by the business

Crowd funding
Money raised through an appeal to public
Overdraft
An arrangement with a bank to spend more money than it has in its account

Retained profit
Profit not distributed to owners
Loan
Sums borrowed for a certain period at an agreed rate of interest

Owners' capital
Money from savings put into the business by the owner

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5:4 Breakeven

Break-even forecast
A prediction about the break-even quantity based on estimates of future sales revenues and costs

Break-even quantity
The amount a business must sell to earn enough revenue to cover its costs

Margin of safety
The amount by which a business' actual output is greater than its break-even output

Businesses use information about revenues and costs to calculate the break-even level of output

Calculating break even

Total fixed costs ÷ (price - variable costs per unit)

Usefulness of break-even analysis

- It will help when taking out loans
- Can make decisions about price and costs
- Can find expected profit
- See how much you need to sell
- Shows the margin of safety

Limitations of break-even analysis

- Prices may change because of promotions
- Costs may change
- A price increase could lead to a fall in sales
- Competitors may change
- The product may enter the decline stage

5:5 Cash Flow

Cash flow forecast: shows the expected flow of money into and out of a business

Inflows
Cash flowing into the business

Outflows
Cash flowing out of the business

Expenditure
Money that the business pays out

Opening balance
Cash available at the start of the month

Closing balance
Cash available at the end of the month

Usefulness of cash flow forecasts

- A planning tool
- Enables remedies to be put in place for shortages
- Anticipates periods of cash shortage
- Provides targets

A negative cash flow may:

- only be temporary and may not necessarily cause a problem for the business
- require the business to obtain additional finance in the form of an overdraft to help it overcome a shortage of cash
- mean that the business has to delay payment of money it owes to others such as suppliers

Assessment Information

Your assessment will take place during a normal timetabled lesson but you should be revising at home.

Number of marks available: 40
Time allowed: 50 minutes

Answer **ALL** of the questions

The first 10 questions will be multiple choice - you must only select **ONE** answer, selecting two will score 0 marks.

The other questions will include a range of 2, 3, 4, 6, 7, & 9 mark questions

Possible questions

1. State one function of the finance department.
2. Calculate the profit a business would make in 4 weeks.
3. Analyse one benefit of owners' savings.
4. Recommend one source of finance for a business to use.
5. Evaluate whether a business should use a bank loan or retained profit.

State **Explain** **Analyse** **Recommend** **Evaluate**