BTEC Level 3 Business: Unit 3 Personal and Business Finance

A1: Functions and Role and Money

Money flows in two directions, into your ownership and out. It comes from various sources including wages, gifts and savings. Money goes out to pay for necessities and wants. The same can be said for a business – money comes in from sources, including sales and bank loans, and goes out to pay day-to-day expenses and fund expansion. Therefore, the ability to handle money received, and to control money paid, is a requirement for personal and business success.

Functions of Money

The functions of money are the jobs that it performs.

- **Unit of account:**
  - It allows us to place a monetary value on goods and services.
  - The price of goods and services show the unit of account, e.g. a chocolate bar is 60p.
- **Means of exchange:**
  - It allows us to trade.
  - Businesses and customers can buy and sell goods and services using money.
- **Store of value:**
  - It allows us to use it in the future as it keeps its value.
  - You might have money saved in a bank account which you can then use to buy goods and services in the future.
- **Legal tender:**
  - It is a legally recognised form of payment.
  - Money is widely recognised and used for all sorts of transactions from buying an ice cream or getting a haircut to paying a deposit on a house and receiving your wages.

Role of Money

Life stage	Financial needs	Implications
Childhood	• Limited needs • Mainly reliant on parents • May want to buy sweets or toys	Money received from presents may be spent as attitude will be that this is to buy things you want May be encouraged to save or parents or grandparents may set up a savings account for you into which they make regular payments May rely on pocket money
Adolescence	• Want to be more independent • Slightly less reliant on parents as want to socialise away from family	May look for a part-time job Still partially reliant on pocket money More likely to receive cash as gifts and may be willing to save up smaller amounts in order to make bigger purchases
Young adult (This is a very big stage which can encompass a wide range of different scenarios depending upon life choices)	• University or starting a career • Looking to be more independent • Buying a car and buying or renting a flat or house • Looking to settle down and maybe get married or start a family	May take a student loan if going to university Borrow money to pay for a car or purchase one on a finance deal May be looking at taking out a mortgage Need to earn money to support self and others Eligible for credit and debit cards
Middle age	• Support family • Start saving for children's futures, e.g. university, weddings, etc. • Look to improve own lifestyle, e.g. new car or move house • Enjoy having access to additional money to spend on luxuries such as foreign holidays	Savings accounts for specific purposes Paying a mortgage Planning for own future through pensions and retirement plans Likely to be the stage of life when income peaks but matched with high expenditure
Old age	• Fewer dependents • May downsize, e.g. move from family home to a smaller retirement home • Fewer financial needs for assets but may be higher for services such as health care	Mortgage payments stop or become lower Less income as reliant on a pension rather than a salary

- **Life events:** Events throughout your life will impact your attitude to money. These events may be within your control, going to university or travelling abroad or may be outside your control, illness, financial gains or losses.
- **External influences:** Factors outside your control, like the state of the economy, will have an impact. Impacting your wages, jobs and prices of goods/services. It will also affect the amount of tax paid. Affecting the ability to spend/save.
- **Interest rates:** When interest rates are low you may be more willing to borrow money or spend on credit. When interest rates are high there is more of an incentive to save.

Different people will have different attitudes to money.

People's attitude to money can change based on the situation they are in.

- **Personal attitudes:** People's attitudes vary in relation to risk and reward and saving and borrowing. You can be a risk averse, to avoid the risk or your could be willing to take the more risks, perhaps enjoying the risk taking, meaning you are incentivised by the potential rewards available. Equally, you may be more or less likely than other to save your money, rather than spending it. This can be dependent on your family's attitude to money, which will also influence your attitude to borrowing as well. You could live within the restraints of only buying what you need and not what you want, or you good buy goods/services on credit or borrow the money to get it quicker.
- **Life stages:** As you grow up from a child to an adult, your financial needs change. Each stage of your life has different implications that will affect your needs and attitudes to money.
- **Culture different:** Cultures, religion and ethical beliefs, will have different attitudes to money. The older generation of Chinese people, have a culture of saving. However, as the country becomes wealthier young people are more willing to spend and even buy on credit.

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A1: Functions and Role and Money

Planning Expenditure

- When planning expenditure, it is important to consider a number of common principles, to avoid be put at risk of financial difficulties now and in the future. You should look to control costs in order to avoid getting into debt in the future. If your spending is too high, so more money is going out than coming in. Which will leads to the build-up of debt, which is expensive as interest is charged on money owed. This will affect your credit rating, reducing your ability to borrow in the future. In extreme cases, people may declare bankruptcy.
- To remain solvent, you should set financial targets and goals. Considering how much money you want to earn, placing limits on how much you will spend. If you save your income, this can help generate future. Savings will also help provide a safety net for the future.
- Inflation is a general rise in prices. This leads to the value of money falling, that is, £10 today is worth less than £10 ten years ago. Expenditure now can help counter the effects of inflation.

A2: Different ways to pay

One of the functions of money is as a means of exchange. This means you can use it to pay for things. There are, however, a number of ways of paying for things – not just with notes and coins. Therefore any method of payment is classed as money.

STORE CARD

Allows a customer to buy on credit in a particular store or group of stores, a minimum payment is required each month upon receipt of a statement

May reward frequent shoppers, additional benefits such as events or discounts, can choose how much to pay each month above a minimum amount, spread cost of spending	May encourage debt, interest will be charged on balances not paid off at the end of a month, can open for multiple stores!

STANDING ORDER

Permission given to the bank to make regular payments, of a set amount, to a third party upon request.

Secure method of payment, ensures regular payments are not missed.	Money taken regardless of balance, must be reset or cancelled if anything changes.

PRE-PAID CARD

A cash balance is held on a card which then reduces each time a transaction takes place e.g. Oyster travel card or school lunch card

Can only spend up to the amount uploaded, secure method of payment, can only be used for specific purpose	Can be difficult to monitor balance, can be used by others without permission, may involve a fee to purchase the card in the first instance.

ELECTRONIC TRANSFER

Online transfer of money from one account to another.

Quick method of payment, transfer is almost instant, can be done remotely e.g. by mobile app	Need to be carefully set up to ensure the transfer goes to the right place.

CREDIT CARD

Make purchases on credit i.e. buy now and pay later. Repayments are made following the issue of a statement with a minimum amount

Allows you to defer and spread payment, widely accepted, used online or in store	Interest is charged on the outstanding balance, can encourage over spending.

CHARGE CARD

Allows for purchases to be paid on a credit card but the total amount is automatically paid direct from a bank account upon receipt of a statement each month.

Secure method of payment, avoids long term debt.	May incur annual or monthly fees, has to be paid in full regardless of funds.

DIRECT DEBIT

Permission given to the bank to make regular payments to a third party upon request.

Ensures regular payments are not missed	Amount taken will vary making budgeting difficult, need to be re set up if bank details change, taken automatically.

CLEARING HOUSE AUTOMATED PAYMENT SYSTEMS (CHAPS)

Same day transfer of funds from one bank account to another.

Quick, but time frames vary, secure, avoids handling cash, sending cheques etc.	May incur additional charges per transaction, must make sure details are correct

CHEQUE

A paper transaction giving a bank permission to transfer payment from your account to another account. Now largely seen as old fashioned.

Secure method of payment, widely accepted, appropriate for postal transactions	Maybe charged for each cheque processed, costly if cheque is not honoured due to insufficient funds.

MOBILE BANKING

Making transactions using a mobile phone or other portable device such as a tablet

Convenient, increasingly popular	Still developing, relies upon the customer having a mobile device

FASTER PAYMENTS SERVICES (FPS)

Direct transfer of money from one bank account to another, guaranteed within 2 hours but may be quicker.

Quick, but time frames vary, secure, avoids handling cash, sending cheques etc.	May incur additional charges per transaction, must make sure details are correct

CASH

Notes and Coins

Confident, widely accepted, small denominations, easy to control expenditure.	Risk of loss or theft, physical transactions only, inappropriate for large items of expenditure.

BANKER'S AUTOMATED CLEARING SERVICES (BACS)

Direct transfer of money from one bank account to another, may take a few days.

Quick, but time frames vary, secure, avoids handling cash, sending cheques etc.	May incur additional charges per transaction, must make sure details are correct

DEBIT CARD

Allows you to make purchases by card with the money being taken directly from a current account. Used to withdraw cash.

Secure, widely accepted, can withdraw cash from various places.	Need to monitor spending and bank balance, if overspend can be costly.

A3: Current Accounts

A current account is an account with a bank or building society that is designed for frequent use. Money can be paid in and withdrawn on a daily basis without the need to give notice. Most people will use a current account to get wages paid into, to pay cheques into and out of, pay bills and other frequent expenses, and to withdraw cash. In the same way as a business changes the features of its products to try and be competitive and attract customers, banks will try to attract customers by changing the features of their accounts.

The features of a current account will include:

- ✓ Rate of interest paid on any positive balance
- ✓ Rate of interest charged on a negative balance
- ✓ Overdraft limit
- ✓ Charges on unauthorised overdrafts
- ✓ Additional incentives.

Types of current accounts:

- **Standard:** This is the normal account offered to customers with a reasonable credit rating. It includes standard features such as the ability to pay and withdraw money, cheque book, debit card, interest payments on positive balances and a pre-agreed overdraft limit.
- **Packaged, premium:** This account offers additional features to a standard account, e.g. car and house insurance, credit card protection, breakdown cover and cash back on certain transactions. The bank may have additional charges for these.
- **Basic:** This account offers only limited features designed for those customers who may otherwise find it difficult to open a bank account due to poor credit ratings. A basic account will not offer an overdraft and will not pay interest on positive balances.
- **Student:** This account is designed specifically to meet the needs of learners. Common features include an agreed overdraft limit and incentives to join the bank, for example free rail cards or cash. Banks are keen to attract learners because once a young person has joined a bank they tend to stay with that bank for life.

Type of current account	Advantages	Disadvantages
Standard	No charges on credit balances Offers the holder a wide range of facilities including a cheque book, debit/cash card and possibly an overdraft facility Convenient for receiving regular payments, e.g. wages and making regular withdrawals	Potentially high charges on the use of an overdraft facility Standard features only, i.e. no additional perks
Packaged, premium	No charges on credit balances Offers the holder a wide range of facilities including a cheque book, debit/cash card and possibly an overdraft facility Convenient for receiving regular payments, e.g. wages and making regular withdrawals Offers the holder additional perks at a packaged price cheaper than acquiring them individually (standard additional features include things such as holiday/travel insurance, break down cover and phone protection)	Additional monthly charge is frequently applied The package offered may not offer value for money or meet the needs of the individual account holder
Basic	Available to customers with a low credit rating Offers an easy first step for individuals to gain access to basic banking facilities, i.e. the ability to pay in and withdraw cash	Limited facilities, e.g. no debit card or overdraft facility
Student	Course fees and student loans can be easily handled Bonuses offered are designed to meet the needs of learners, e.g. discounts on travel or small lump sum cash payment	Overdraft facilities could encourage overspending Charges for overspending are high Limited facilities

A4: Managing Personal Finance

Few businesses have just one product. They have a range of products to meet the needs of different customers. A car manufacturer, such as Ford, will have cars to match different incomes, lifestyles, family size and preferences. This is also true of banks, building societies and other providers of financial services. They will all offer a range of products to match the needs of different individuals. Financial services will include borrowing.

Different types of borrowing

- **Overdraft:**
  - This allows you to withdraw money that you do not have from a current account.
  - It may be suitable to meet short term needs, like a shortage of cash just before payday.
- **Personal loan:**
  - This gives you the ability to borrow a set amount of money, to be repaid in regular instalments with interest.
  - It may be suitable to fund the purchase of a high price item such as a car or to make home improvements.
- **Hire purchase:**
  - This allows you to have use of an item immediately but pay for it in regular instalments. The item remains the property of the seller until all instalments have been made.
  - It may be suitable for one-off or infrequent purchases, like a TV or fridge freezer.
- **Mortgage:**
  - This is a long-term loan to fund the purchase of assets, normally paid back over a long time, like 25 years.
  - It is secured against an item, like a house.
  - It is suitable for assets that will maintain value for a long time and cannot normally be paid for outright.
- **Credit card:**
  - Goods are paid for by card and can be paid for either at the end of a set period, when a statement is issued or over time with the card provider stating a minimum payment each month. Being a percentage of the balance.
  - It may be suitable when buying high price goods or services, like a holiday, or at times when expenses are higher than usual, like Christmas, to spread the costs of spending.
  - It may also just be used for convenience and safety as an alternative to using cash.
- **Payday loan:**
  - This is a short term source of finance used to bridge the gap between now and next receiving a wage. It will normally only available for relatively small amounts at very high rates.
  - It may be suitable in an emergency to meet cash shortages.

Type of borrowing	Advantages	Disadvantages
Overdraft	Interest is charged only on the amount outstanding Can be paid off without penalties An overdraft facility can be prearranged and only used if needed Provides a short term solution to cash flow problems	When used, interest charges are often high Additional penalty charges for going over a pre-arranged limit are often very high Not the cheapest form of borrowing The ease with which these can be obtained could encourage overspending
Personal loans	Regular, pre-agreed payments make planning and budgeting easy As a general rule these would only be issued to individuals who can prove their ability to make the repayments Useful when looking to purchase a specific item of medium to high value, e.g. a car or home improvement	May have to be secured against an asset which means if payments are missed the asset may be taken to cover the outstanding debt Not really suitable for short term loans
Hire purchase	Spreads the cost of an expensive item over a period of time Credit is secured against a specific item Often allows a customer to afford something now that they could not otherwise afford, e.g. four years' interest free on furniture	Interest charges may be higher than other traditional loans Ownership of the asset may legally be kept by the seller until the final payment is made Agreements can be manipulated to make a purchase seem deceptively appealing
Mortgages	Allows the customer to spread the cost of expensive items over a long period of time, e.g. the purchase of a house is often spread over 25 years Interest rates, depending upon the mortgage deal, can sometimes be fixed or tracked against a standard rate of interest reducing the risk of fluctuations	Interest payments, although sometimes fixed for a short period of time, can vary – this seriously affects the borrower's ability to repay or meet other expenses Failure to meet repayments may lead to a loss of a home and seriously affect an individual's future credit rating Penalties may be applied to early repayment
Credit cards	The credit card holder can pay above the minimum rate if they wish and hence speed up the rate of repayment and reduce interest incurred Can be used for items of multiple sizes and value, to a limit, without the need to secure against an asset Provides some protection on purchases	Can encourage overspending, sometimes on unnecessary purchases, and can lead to debt problems Interest rates are often higher than on a personal loan
Payday loans	Help solve immediate short term cash flow problems Relatively easy to secure	Interest rates are very high and the cumulative amount to be repaid can quickly spiral out of control

A4: Managing Personal Finance

Managing personal finance can also include saving and investment. These options are open to you when you are earning or receiving more money than you need to cover your expenditure. Even when income and expenditure are the same or similar, it can be wise to take advantage of opportunities to save and invest to increase future wealth.

Different types of saving and investment

- **Individual savings accounts (ISA):** This is a type of saving account where the holder is not charged income tax on the interest received.
- **Deposit and savings accounts:** These are accounts where interest is paid on the balance and normally the holder needs to give notice before withdrawing funds.
- **Premium bonds:** A government scheme that allows individuals to save up to a set amount by buying bonds. The bond holder does not receive interest on their savings but each bond is placed into a regular draw for cash prizes.
- **Bonds and gilts:** These are fixed term securities where the lender (the individual) lends money to companies and governments in return for interest payments, over time.
- **Shares:** Shares involve investment in a business in return for equity, i.e. the shareholder becomes a part owner of the business. The shareholder will receive dividends from the company's profits and will also want the value of the shares to increase.
- **Pensions:** These are long-term savings plans where people make regular contributions, called premium payments, throughout their working life. This is then repaid as either a lump sum, regular payments or a combination of the two upon retirement. Pensions can be state, company or private.

Type of saving and investment	Advantages	Disadvantages
Individual savings accounts (ISAs)	Tax is not charged on interest earned allowing the saver to keep all of the rewards for saving Interest rates are sometimes slightly higher than in alternative savings accounts	Notice is often required to make withdrawals and according to the agreement there may be a limit set on the number of withdrawals made If the saver makes more withdrawals than set out in the agreement then the penalty may cancel out the tax savings There is a limit set on the annual amount that can be placed in an ISA
Deposit and savings accounts	Interest is earned on positive balances Accounts sometimes require regular deposits of a set amount forcing the saver to follow a savings plan	Interest earned is taxed The percentage rate of interest paid on savings is likely to be lower than interest to be paid on borrowing, therefore the benefits of savings are lost if the customer is borrowing at the same time
Premium bonds	Chance of winning substantially more than could be earned in interest Can be easily withdrawn with no loss or penalty	No guaranteed return on investment Maximum amount reviewed annually by the government The amount invested, assuming zero or low returns, loses value due to inflation
Bonds and gilts	Regular fixed returns Spreads risk across a range of markets	Risk of losing some or all of the value of the investment if the bond or guilt value falls Interest payments may not be received if the issuer is unable to make payments
Shares	Share prices fluctuate offering a potential high reward Shareholders' returns can include dividend payments and an increase in share value As part owners in a business there may be additional benefits including discounts and special offers For some investors share ownership is more than just a way of saving – it is a pastime and creates interest	Share prices fluctuate offering a potential high risk There is no guarantee of any reward or return as all of an investment can be lost
Pensions	Encourages individuals to save throughout their working life for retirement Depending upon the policy, an individual's savings may be boosted by an employer's contributions increasing the final value of the saving Regular payments are deducted, sometimes at source, meaning the individual is tied into making the regular contributions	Movement between jobs may mean that one policy stops and another starts, thus reducing the overall cumulative value of the savings Final outcome is difficult to predict If compulsory payments are deducted this may affect short-term living standards

A4: Managing Personal Finance

Risk and reward of saving VS. Investment

Saving and investment both involve forfeiting current spending in the hope of gaining greater wealth in the future. Saving involves placing extra money in a secure place where it will hopefully grow as it gains interest. If you are saving your money, it is often with a view to buying a specific good in the future or to support a planned future lifestyle. Many parents will start to save when a child is born to pay future college fees or to support the child at they grow up. Investment involves making a commitment to a project in the hope that it is successful and a healthy return is made on the investment.

	Risks	Rewards
Saving	• Low or zero risk as money saved is guaranteed to be available in the future • Inflation can reduce the spending power of money saved	• Interest payments • Financial security/peace of mind
Investment	• Investments can go wrong and all or some of the value may be lost • No guarantee of a return	• If successful, there is potential for a high financial return (significantly higher than could be earned in interest) • Can be exciting! Some people will invest in shares, antiques, art or foreign currencies, for example, in the hope of high returns

Different types of insurance

- **Car:**
  - It is a legal requirement to insure any car that is on the road – this covers theft as well as accidents, protecting the driver, passengers and road users. Depending on the cover; third/comprehensive.
- **Home and contents:**
  - Home insurance covers the physical building.
  - Contents insurance covers the physical items in the house. If there are individual items of high value, then they may need to be specified on the policy.
- **Life assurance and insurance:**
  - Life assurance is an ongoing policy to pay a lump sum upon death.
  - Life insurance is a policy for a set period of time to pay a lump sum if you die within that time period.
- **Travel:**
  - This protects individuals or groups while abroad. Policies can be purchased to cover trips, like loss or theft of property, illness, cancellation and emergencies up to predetermined limits.
- **Pet:**
  - This protects the owners of pets against the expenses associated with treating ill or injured pets.
- **Health:**
  - This covers people against medical expenses like assessments, treatments and loss of earnings.
  - In the UK the NHS provides free medical care but individuals may wish to take out insurance to receive payments if, like private treatment.

Insurance is a form of protection. Specific items, individuals and pets can be insured. Insurance policies cover the cost of loss, damage or illness up to prearranged levels in return for regular payments called premiums. Insurance can be taken out against anything deemed to have a worth or where there is a risk of financial loss. The premium paid will vary depending upon the amount of cover provided and the amount of risk as assessed by the insurance provider.

Type of insurance	Advantages	Disadvantages
Car	Meets legal requirements Protects self against theft or damage Protects against damage caused to a third party	Premiums can be high depending upon assessed level of risk, e.g. expensive for young drivers Normally there is an excess that must be paid, e.g. first £500 of all damages is still the responsibility of the car owner
Home and contents	Protects against damage which may otherwise be too expensive to repair resulting in the loss of a home Contents are protected both when inside the house and outside	Premiums are an additional expense to home ownership Some items cannot be replaced due to a value beyond the financial worth, e.g. a painting or inherited piece of jewellery
Life assurance and insurance	Provides peace of mind to family following the bereavement of a homeowner	If the policy holder does not die within the period of life insurance no payment is made (could be seen as an advantage!)
Travel	Provides protection for personal belongings when away from home Covers medical costs when on holiday Protects against cancellation and sometimes delays	The person suffering the loss is likely to have to pay upfront to replace items or cover medical costs and then reclaim later An additional cost when travelling abroad
Pet	Avoids expensive vet fees If vet fees are too high, there may be no alternative to having the pet put down – insurance can avoid this	An additional monthly expense to protect against the unexpected
Health	Some compensation is provided when ill which can reduce the financial burden and stress allowing the patient to concentrate on recovery rather than financial worries If used to fund private care, this often results in quicker treatment and better facilities	Paying for something that you hope you will not use Premiums can be expensive depending upon the degree of cover required Will not cover pre-known conditions

B1: Features of Financial Institutions

Financial institutions are organisations that offer financial services to individual and/or businesses. There are a range of services and advice that they offer.

Types of organisations

- **Bank of England**

The UK's central bank with the responsibility for maintaining a healthy level of financial stability. Their responsibilities include; issuing legal tender, setting interest rates and controlling the national debt.
Bank of England

- **Banks**

Banks are organisations that handle financial transactions and stores money for its customers. They offer services such as holding deposits, making payments when instructed to and supplying credit.

- **Building Societies**

Organisations what handle transactions and store money for their customers. The members who hold accounts are part owners of the building society and have a right to vote and receive information about the running of the society.

- **Credit Unions**

A not for profit organisation that handles financial transactions and stores money on behalf of their members. Members are their owners and have a voting right.

- **National Savings and Investments**

A government backed organisation that offers a secure saving option. It offers a range of options including ISA's and premium bonds.

- **Insurance Companies**

A profit making organisation that protects its policy holders against the risk of loss in return for a premium.

- **Pension Companies**

Businesses that sell policies to individuals, either privately or through their employer, allowing them to saved a fund for retirement.

- **Pawnbrokers**

Businesses who loan money against the security of an item, eg: jewellery or electronic equipment.

- **Payday Loans**

Organisations that offer a short-term source of finance, designed to bridge the gap between now and payday to meet cash shortages,. Available for small sums at high interest rates.

Type of organisation	Advantages	Disadvantages
Bank of England	Responsible for protecting the financial stability of the economy as a whole Sets interest rates at a level designed to help achieve a stable economy Lends to banks	Not a bank for members of the general public Can raise interest rates making borrowing more expensive
Banks	Offer a range of services and account types Provide a secure place to store money Pay interest on credit balances on most types of accounts	Savings are only protected up to the value of £75,000, so if a bank goes bankrupt savings above this would be lost Profit-making organisations owned by shareholders, therefore costs to individuals may be higher than necessary in order to fulfil shareholder objectives
Building societies	Offer a range of services and account types Provide a secure place to store money Pay interest on credit balances on most types of accounts Owned by members and therefore costs can be kept down allowing for higher interest payments	Savings are only protected up to the value of £75,000, so if a building society goes bankrupt savings above this would be lost May lack the business drive of a commercial bank
Credit unions	Offer a range of services and account types Provide a secure place to store money Owned by members and therefore costs can be kept down allowing for higher interest payments Often offer additional benefits to the community or a good cause	Savings are only protected up to the value of £75,000, so if a credit union goes bankrupt savings above this would be lost May lack the business drive of a commercial bank
National Savings and Investment	Government-backed, therefore offering security on 100% of savings with no upper limit Offers additional services/methods of savings, e.g. premium bonds	Rates are variable Not as easy to access due to lack of a high street presence Often required to give notice on withdrawals
Insurance companies	Protect against unexpected losses or financial expenses Easy and regular monthly payments make planning easy Wide range of services and levels of cover to suit the needs of individuals	Premiums are assessed on the estimated degree of risk which may be seen to penalise some members or groups of society too harshly Profit-making organisations, therefore premiums will be charged to ensure shareholder needs are met
Pension companies	Provides a structure to help plan for financial security after retirement Deductions can be taken directly from pay and be fully or partially matched by an employer's contribution Experts are employed to make investment decisions	Poor investment decisions by the pension company may result in a disappointing return Money already invested in a pension cannot be released prior to the dates agreed in the policy
Pawnbrokers	A quick way of acquiring cash needed for a short period of time The asset can be brought back within a set period of time Interest is not charged	The amount given for the asset is often substantially lower than its actual worth If the money is not repaid within the agreed period, the asset will be sold on
Payday loans	A quick way of acquiring cash needed for a short period of time	Interest charges are likely to be very high Often results in paying back a final sum substantially higher than the initial amount borrowed

B2: Communicating with Customers

Communicating with customers was traditionally carried out face to face. This meant that there was a personal relationship between the customer and the organisation. Over time, as technology has developed the way customers communicate with banks has developed and become less personal.

Methods of interacting with Customers

- **Branch**
A physical place where the customer will visit the premises to carry out transactions face to face.
- **Online Banking**
The use of the internet to carry out banking transactions
- **Telephone Banking**
When transactions are carried out over the telephone
- **Mobile Banking**
The use of a mobile device such as a mobile phone or tablet to conduct financial transactions
- **Postal Banking**
The use of the postal system to carry out paper-based financial transactions

Method	Advantages	Disadvantages
Branch	Opportunity to build a relationship developing trust and brand loyalty Transactions can be conducted there and then Additional services such as advice can be offered Gives the customer a high level of confidence	Need to travel to a branch which is likely to incur travel costs, e.g. parking or fares for public transport Restricted to bank opening hours May be long queues plus travel time, making the process time consuming
Online banking	Available 24/7 High degree of privacy Convenient	Takes time at the beginning to set up or apply for Not suitable for cash withdrawals Increased risk due to cyber crime If just an online account, the facilities may be limited
Telephone banking	Convenient, especially to access basic functions such as checking a balance No additional charges	Full access may be limited to set hours Call centres and automated telephone systems can frustrate customers Higher risk of fraud and identity theft
Mobile banking	Convenient Available 24/7 No additional charges	May need to download specific apps to access mobile banking for a particular bank Higher security risk due to increased risk of loss or theft of mobile devices Can be prone to hackers sending texts asking for bank details
Postal banking	Traditional method that many customers will feel comfortable with Does not require any additional technology or devices	Can be slow due to the postal system Post can get lost

B3:Consumer Protection In Relation to Personal

There are laws and organisations responsible for protecting the rights of consumers in relation to their personal finance.

- **Financial Conduct Authority (FCA)**
An independent organisation who regulate the actions of providers of financial services. It has 3 key areas:
  - Authorisation
  - Supervision
  - Enforcement
- **Financial Ombudsmen Service (FOS)**
An organisation appointed by the government to represent the interests of the consumer in disputes with financial service providers. It is funded by compulsory fees charged to all regulated financial institutions.
- **Financial Services Compensation Scheme (FSCS)**
A UK organisation that will pay compensation to a consumer of financial services if the service provider is unable to.
- **Office of Fair Trading (OFT)**
A government organisation that was established to regulate all markets, It had the aim to encourage fair practices and health competition between financial institutions.
- **Legislation: Consumer Credit**
A law passed by UK government to enforce the regulation of any firm offering credit. All firms offering credit have to registered with the FCA,

B4: Information, Guidance and Advice

Personal finance can be complicated and is important to individuals. There are government funded and independent organisations which offer help and support to aspects of personal finance.

Types of organisations

- **Citizens Advice**

- **Independent Financial Advisor (IFA)**

Professionals who offer independent advice to their clients on financial matters such as; savings, investments, mortgages and pensions

- **Price Comparison Websites**

These websites allow consumers to make comparisons between different types of products. For example, insurance, credit cards etc

- **Money Advice Service**

A government organisation that is set up to offer free and impartial advice in the UK

- **Debt Counsellors**

This ia a professional who offers personal advice on how best to manage debt.

- **Individual Voluntary Arrangements (IVAs)**

A government organisation that allows an individual to declare themselves bankrupt while agreeing to pay all or part of the money that they owe to creditors through an insolvency practitioner.

Provider	Advantages	Disadvantages
Citizens Advice	Free service Offers face to face as well as online and telephone advice Wide range of areas covered	Trained volunteers are not necessarily professionals in financial issues and therefore knowledge may be limited
Independent financial advisor (IFA)	Advice is offered by professionals in the field Services offered are regulated by the FCA and FOS Advisers will take time to understand an individual's full financial situation	Services will be charged for Advice offered is not guaranteed to be 100% up to date or unbiased
Price comparison websites	Easy to access 24/7 Free service	Not guaranteed to be 100% up to date, accurate or unbiased Do not always cover all of the available options Potential for bias
Money advice service	Government-funded therefore advice is free and impartial Covers a wide range of financial matters	Advice is only available online or over the telephone – no physical presence Can take time to find and understand the exact advice that is being searched for Advice can be generic rather than personal
Debt counsellors	Advice is offered by a professional who specialises in debt management Services offered are regulated by the FCA and FOS	Services will be charged for Advice will focus just on debt management rather than the whole package of financial concerns
Individual Voluntary Arrangements (IVAs) bankruptcy	Helps manage debt repayment with regular payments making budgeting easier Independent advice, without bias	Set up and handling fees are charged for the service Will affect future credit ratings

BTEC Level 3 Business: Unit 3 Personal and Business Finance

C1: Purpose of Accounting

Accounting involves the recording of financial transactions, planned or actual and how these figures are used to provide financial information.

Purpose of Accounting

Record Transactions
- Must be kept up to date
- Must record all of the money coming into the business and all of the money going out
- If these records are not kept, issues could arise like non payment from debtors
- HMRC require records to be kept to ensure that financial performance is reported accurately

Compliance
- Financial reporting is governed by laws and regulations to ensure that a business gives an accurate picture of where it is working.
- It is important to follow these laws and regulations to ensure that investors and other stakeholders are not misinformed
- Compliance also helps protect against fraud

Management of the Business
- Managers are responsible for the planning, monitoring and controlling of the resources in their specific area
- Understanding the business accounts will enable managers to make more informed decision

Measuring Performance
- Without financial records it would be impossible to know if the business was making a profit or a loss

Control
- Accounting will control the flow of money into and out of the business
- Unusual activity should be spotted, helping to prevent fraud.
- Tracks the amount the business owes and is owed
- Helps to ensure that the business can meet its day-to-day expenses

C2: Types of Income

Income is money coming into the business. There are two types of income: capital income and revenue income.

Capital Income

Loans
- An amount of money leant to a business or business owner(s) from a financial institution

Mortgages
- A large sum of money and typically over 25 years that is secured on an asset (usually premises)

Shares
- Shareholders all contribute capital income when they purchase shares

Owners Capital
- Money invested by the owner of the business

Debentures
- Medium- to long term sources. Interest is payable and the debenture normally get paid back in a large lump sum on a pre-agreed date

Revenue Income

Sales
- Money coming in from the sale of goods/services. They can be cash or credit sales

Rent Received
- A business that owns property or land and charges others to use it

Commission Received
- A business may sell products/services as an agent of another business. They get paid a percentage of the sales and this is called commission

Interest Received
- Money earned on savings or lending

Discount Received
- When a business is given a percentage off a sale, normally in return for quick payment or a bulk order

C3: Types of Expenditure

Expenditure is money spent by a business and can be split into two categories: capital expenditure and revenue expenditure.

Capital Expenditure

Non-current assets
- Non-current assets are items owned by a business that will remain with them for a reasonable period of time
- Includes: land and premises, machinery and equipment, vehicles, fixtures and fittings

Intangibles
- Something that is owned by the business but cannot physically be touched, for example:
  - Goodwill
  - Patents
  - Trademarks
  - Brand name

Revenue Expenditure

Inventory
- Most businesses will require some kind of inventory
- When a business is starting up they are likely to have to use cash to pay for their inventory due to not having a relationship with creditors.
- Larger businesses may be able to drive the cost of inventory down due to buying in larger quantities
- There are other costs associated with inventory such as storage or insurance

Rent
- The cost of premises not owned by a business, usually a monthly payment

Rates
- Businesses need to pay non-domestic rates
- A sum of money paid to the local council to go towards services such as street lighting or rubbish collection

Heating and Lighting
- This covers payments for gas and electric, they are usually quarterly

Water
- This is the payment of water to use.
- A fixed rate or based upon a water meter

Insurance

A business is legally required to take out a number of types of insurance to protect itself from serious losses. These include:
- Buildings insurance
- Contents insurance
- Public liability insurance
- Employers liability insurance

Administration
- Refers to the paperwork that goes on within a business either internally between employees or externally with suppliers and customers

Salaries
- An annual figure paid to an employee in equal monthly instalments

Wages
- Wages are an hourly figure paid to an employee

Marketing
- This covers the wide range of costs associated with attracting the customer and convincing them to make the purchase

Bank Charges
- Banks charge businesses for each transaction made
- Sometimes offered free to businesses in the first year

Interest Paid
- If the business has a liability such as a bank loan or mortgage, then interest will be charged om this
- The less risk a business is, the less interest they will pay

Depreciation
- Assets lose value over time, this is called depreciation
- Depreciation is a paper exercise to match the cost of an asset against the time it is used within a business

Discount Allowed
- Reductions that are offered to customers are an expense to a business as it reduces the amount of cash flowing into the business

BTEC Level 3 Business: **Unit 3 Personal and Business Finance**

D1: Sources of Finance

Businesses need finance for a wide number of reasons, both to fund capital and revenue expenditure. What the money is going to be used for will depend on which method is most suitable.

Internal Sources of Finance

- **Retained Profit**
  Profit kept in the business to fund future expenditure
- **Net Current Sales**
  Current assets minus current liabilities shows the money available in a business to fund day-to-day expenditure
- **Sale of Assets**
  Selling an item of worth owned by the business to get an immediate cash injection

External Sources of Finance

- **Owners Capital**
  Money invested in the business from the owners personal savings
- **Loans**
  Money borrowed by financial institutions with interest, for a set period of time
- **Crowd-funding**
  Involves attracting investment from a large number of speculative investors who are like to invest small amounts
- **Mortgages**
  A long term loan (normally 25 years) that is secured against an asset, such as a building
- **Venture Capital**
  Investment from an experienced entrepreneur in return for a stake in the business
- **Debt Factoring**
  The selling on of a business's debts to a third part to receive the cash quickly.
- **Hire Purchase**
  Paying to use an asset in instalments to spread the cost over its useful life. The asset will remain the property of the seller until the final payment is made.

Internal source of finance	Advantages	Disadvantages
Retained profit	No interest charges Available immediately Only available up to the amount already accumulated by the business and therefore avoids debt No loss of ownership (control)	Amount available may be limited Reduces payments to shareholders which may cause dissatisfaction Once used it is not available for alternative purposes
Net current assets	Encourages the business to manage cash flow effectively	Can put pressure on customers as shorter credit terms are offered and this negatively affects relationships with suppliers if longer credit terms are negotiated Lower stock holdings can affect the firm's ability to meet customer needs
Sale of assets	No interest charges Reduces **capital** tied up in assets, releasing it for other purposes Can mean disposing of an asset no longer of use to the business	It is likely that the amount received is not a true reflection of the value of the asset Can increase costs in the long run if an asset needs to be leased back

	Advantages	Disadvantages
Owner's capital	No interest payments or need to repay High level of commitment from the owner	Amount available is likely to be limited If there is more than one owner this could cause friction if everyone is not able to contribute the same amount
Loans	Regular pre-agreed repayments make planning and budgeting relatively easy Ownership or control is not lost	Interest is charged on the amount borrowed Interest rates can fluctuate Often secured against an asset which can be seized if repayments are missed Interest has to be paid regardless of whether a profit is being made
Crowd-funding	Offers the ability to raise finance from a large number of investors No interest is paid as investors will only be rewarded if the business is successfully sold on at a later date	Partial loss of ownership No guarantee that the crowd fund will attract sufficient investment to meet the proposal
Mortgages	Large amounts of finance can be raised and repaid over a prolonged period of time Ownership or control is not lost	Interest is charged on the amount borrowed Interest rates can fluctuate Often secured against an asset which can be seized if repayments are missed Interest has to be paid regardless of whether a profit is being made Not suitable for small amounts or as a short-term source of finance

	Advantages	Disadvantages
Venture capital	Finance is provided by a business professional who will often offer advice and mentoring alongside the investment Venture capitalists are often risk takers and may see the potential in a high risk investment that other investors including banks may not be willing to invest in	Partial loss of ownership and control Conflict can arise between the entrepreneur and venture capitalist regarding the direction and day-to-day running of the business
Debt factoring	Speeds up the flow of cash into the business from debts The factor company takes on the risk of bad debt	Only receive a percentage of the amount owed, therefore reducing profits Can give the wrong impression or alienate customers
Hire purchase	Avoids the need to pay a lump sum for the use of an asset Regular instalments make planning and budgeting easier Spreads the cost of an asset over its useful life	Overall amount paid for the use of an asset is likely to be higher than if purchased outright Only really suitable for relatively low cost assets, e.g. vehicles and not premises

D1: Sources of Finance

Businesses need finance for a wide number of reasons, both to fund capital and revenue expenditure. What the money is going to be used for will depend on which method is most suitable.

External Sources of Finance

- **Leasing**

Paying to use an asset in instalments to spread the cost over its useful life. Ownership stays with the supplier throughout the length of the lease agreement.

- **Trade Credit**

The period of time offered by suppliers to allow customers to purchase a good or service now and pay at a later date.

- **Grants**

A lump sum provided to a business by the government or another organisation to be used for a specific purpose

- **Donations**

Sums of money given voluntarily to a charity or social enterprise

- **Peer to peer lending**

Involves one business person lending money to another business person in return for interest payments.

- **Invoice Discounting**

Reductions offered to customers making a product or service cheaper, often applied as a percentage.

Leasing	Responsibility for maintaining and repairing the asset stays with the supplier Spreads the cost of an asset over its life to avoid paying a lump sum up front	Overall amount paid for the use of an asset is likely to be higher than if purchased outright Never actually own the asset and therefore payments are ongoing
Trade credit	Delays the need to pay for goods and services purchased, therefore aiding cash flow No loss of ownership or control	Potential loss of discounts offered for cash payments Only suitable as a short-term source of finance
Grants	No need to repay and no interest charges No loss of ownership or control	Often require a lengthy application process Might only be awarded if certain conditions are met affecting the way the business operates on a day-to-day basis
Donations	No need to repay and no interest charges No loss of ownership or control	Likely to be small amounts only Unpredictable
Peer to peer lending	Interest rates can be lower than lending from more traditional financial institutions Fixed rate of interest can be agreed making it easier to plan and budget	Amounts available may be limited and provided for a short period of time only
Invoice discounting	No need to repay and no interest charges No loss of ownership or control Reduces costs to the business so increases profit	Often only available if purchases are paid in cash which affects cash flow

E1: Cash Flow Forecasting

Cash flows into and out of a business on a regular basis. A cash flow forecast tries to predict in advance what and when these cash flows will be.

Inflows

- Inflows are the money coming into the business, for example
  - Cash sales
  - Credit sales
  - Loans
  - Capital introduced
  - Sale of assets
  - Bank interest received

Components of a Cash Flow Forecast

Opening balance: how much is available at the start of the year

	January (£)	February (£)	March (£)
Opening balance (b/f)	1,000	(280)	240
Income			
Sales	1,000	2,800	2,000
Total inflows	1,000	2,800	2,000
Total cash available	2,000	2,520	2,240
Expenses			
Puchases	980	980	500
Wages	1,000	1,000	1,000
Heat & light	300	300	300
Total outflows	2,280	2,280	1,800
Closing balance (c/f)	(280)	240	440

February's closing balance becomes March's opening balance

Cash available = Opening balance + Total inflows £1,000 + £1,000 = £2,000

Closing balance = total cash available – total outflows = £2,000 – £2,280 = (£280)

Brackets are used to show that a figure is negative

Outflows

- Outflows are the payments going out of the business, for example
  - Cash purchases
  - Credit purchases
  - Purchase of assets
  - VAT
  - Bank interest paid
  - Rent
  - Rates
  - Salaries
  - Wages
  - Utilities

Key Formula

- Opening balance

  = Last months closing balance

- Net cash flow

  Inflows - outflows

- Closing balance

  Opening balance + net cash flow

Problems and Solutions with Cash Flow

Problems occur with cash flow when the business outflows are higher than their inflows. Issues occur because businesses rarely have stable cash flow all year

Solutions:

- **Overdraft arrangements:** a business with fluctuating cash flow can use an overdraft to see them through cash shortfalls
- **Negotiating terms with creditors:** could negotiate a longer time to pay creditors, move from 30 to 60 days
- **Reviewing and rescheduling capital expenditure:** find areas where expenditure could be cut or postponed

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E2: Break-even Analysis

Break-even is the point at which a business is not making a profit or a loss. This means that the money being received from sales is the same as the money being spent on costs.

Types of Costs

- **Variable costs**

Vary with the level of output

- **Semi-variable costs**

Part of the cost stays the same and part varies in relation to the degree of the business activity

- **Fixed Costs**

Do not vary with output

- **Total Costs**

Fixed costs + variable costs

Important Terms Relating to Sales

- **Total Revenue**

Quantity sold x selling price

- **Total Sales**

Amount of sales made in a set period

- **Selling Price Per Unit**

The amount a customer pays for each unit bought

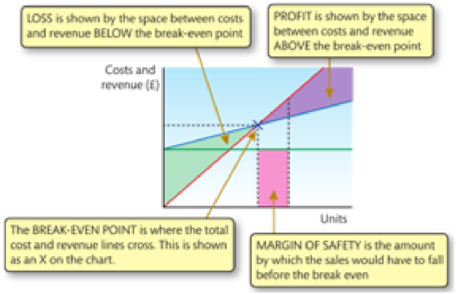
- **Sales in Value**

Sales expressed is monetary value (£)

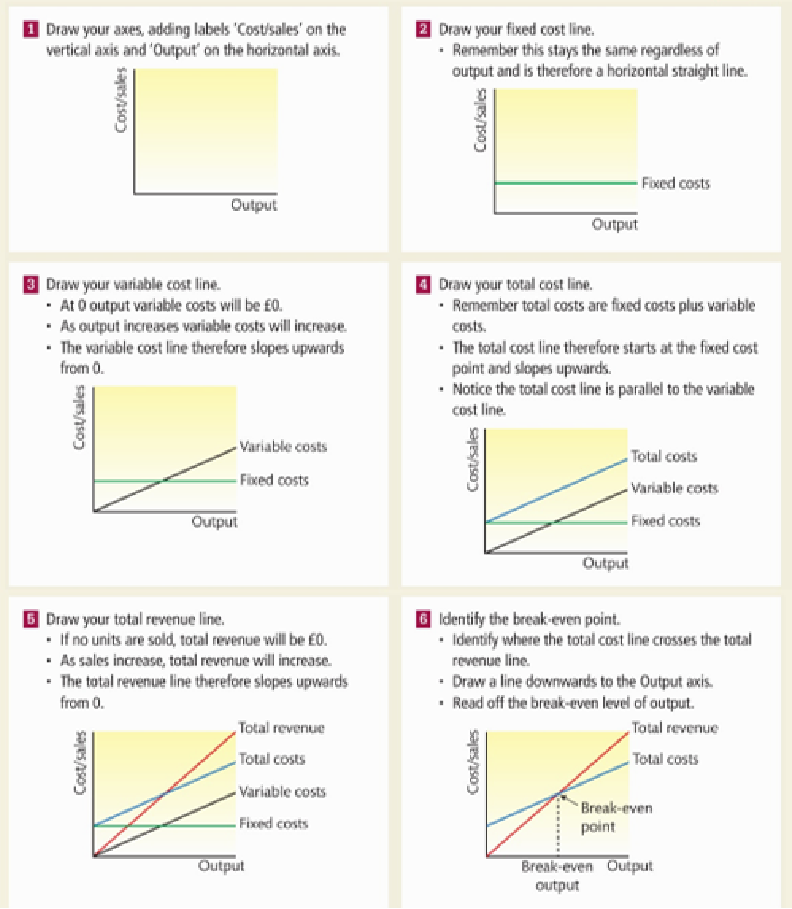
- **Sales in Volume**

Sales expressed in quantity (eg: tons or units)

The parts of a Break Even Chart



Drawing a Break-even Chart



Calculations

- **Break-even point**

$$\text{Break-even point} = \frac{\text{Fixed costs}}{\text{Contribution per unit}}$$

- **Contribution per unit**

Selling price – variable costs per unit

- **Total Contribution**

Sales revenue – total variable costs

- **Total Variable Costs**

Variable cost per unit x quantity

Use of Break-even

- **Planning**
- Set budgets for the amounts of sales and costs
- Forms part of the business plan
- Informs decisions
- **Monitoring**
- Monitor progress
- Identify changes
- Take corrective action
- **Control**
- Keep costs within budget
- Motivate employees
- Manage accounts
- **Target Setting**
- Set sales targets for individuals/teams
- Set expenditure budget
- Set profit budgets based on sales targets and costs targets

F1: Statement of Comprehensive Income

Calculates whether a business has made a profit or loss by deducting all costs from sales. If completed correctly it will give an accurate calculation showing how much profit or loss a business has made, over a period of time (usually a year).

Calculation of Gross Profit

First part of the statement is made up of three components:

1. Sales revenue – money coming into the business
   Quantity sold x selling price

1. Cost of goods sold – costs directly involved in producing the product
   Opening inventories + purchases – closing inventory

2. Gross profit – surplus after the cost of goods sold
   Sales turnover – cost of good sold

Calculation of Profit or Loss for the year

Profit is the money after all other expenses have been deducted from the gross profit and any other income has been added.

Gross profit – expenses + other income

Depreciation

An accountancy concept used to spread the cost of an asset over its useful life.

Straight Line Depreciation

- Asset depreciates by a set amount each year

Reducing Balance Depreciation

- Depreciated by a set percentage of its remaining value each year
- Formula:

$$\frac{\text{Historic value – residual value}}{\text{Expected life}}$$

Analysing the Statement

- Making comparisons between figures within the statement of comprehensive income
- Comparison between years
- Intrafirm comparisons to see how different aspects of the business are performing
- Intrafirm comparisons to see how the business is performing overall compared to competitoes

Statement of comprehensive income for the year ended 30 April 2015	£000s	£000s
Sales		411,529
Less cost of goods sold		
Opening inventory	34,993	
Purchases	128,129	
Closing inventory	21,445	
		141,672
Gross profit		269,852
Less expenses		
Rent and rates		37,554
Wages and salaries		96,221
Telephone and postage		1,359
Distribution		31,593
Advertising		15,579
Miscellaneous expenses		28,452
Depreciation		17,848
Total expenses		228,696
Revenue income		0
Net profit before tax		41,246

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F2: Statement of Financial Position

A statement of financial position is a snapshot of a business's net worth at a particular moment in time, usually the end of a financial year. It is a summary of everything the business owns and owes. It states the value of the business.

Non-current Assets

- Items of value that are owned by the business and likely to stay for longer than a year.
    - Tangible assets can be touched – need to be given a realistic value as they depreciate in value
    - Intangible assets cannot be touched – value of these can change over time

Current Assets

- Items of value owned by a business whose value is likely to fluctuate on a regular basis
- Examples include: inventories, trade receivables, prepayments, cash in the bank and cash in hand
- They are listed in the order of how easy it is to turn them into cash quickly

Current Liabilities

- Owed by the business and should be paid back in less than one year
- Examples include: overdrafts, accruals, trade payables

Net Current Assets/Liabilities

- Very important figure for business
- Represents the business's ability to meet short term debts
- If a business cant afford its liabilities it may have to sell an asset

Non-Current Liabilities

- Liability is something that the business owes
- If it is non-current, the business will not pay it back within one year
- Examples include: bank loans and mortgages

Net Assets

- A figure that represents the total value of all the assets minus the value of the liabilities

Non-current assets +current assets – (current liabilities + long term liabilities)

Capital

- Second half of the statement asks how this has been financed
- Presented as:
    Owners of shareholders capital
    + retained profit
    - Drawings
    - = capital employed

	Cost	Accumulated depreciation	Net book value
	£	£	£
Non-current assets			
Premises	218,000	28,880	189,120
Fixtures and fittings	38,500	15,800	22,700
Vehicles	19,500	19,500	0
Current assets			
Stock			34,294
Debtors			21,455
Cash at bank			0
Cash in hand			381
			56,130
Less current liabilities			
Creditors			17,881
Overdraft			12,389
			30,270
Working capital			25,860
Non-current liabilities			
Bank loans			50,998
Net assets			186,682
Financed by			
Capital			60,000
Retained profit			126,682
Capital employed			**186,682**

BTEC Level 3 Business: Unit 3 Personal and Business Finance

F3: Measuring Profitability

Profitability is the measure of the profit of the firm in relation to another factor. It allows a deeper understanding of the performance of the business as you are able to compare across years, industry etc.

Gross Profit Margin

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

- Looks at gross profit as a percentage of sales turnover.
- It shows for every £1 made in sales, how much is left as gross profit.
- If this falls from one year to the next or if it is too low, a business may look to reduce the cost of its purchases or increase sales

Net Profit Margin

$$\frac{\text{Net Profit}}{\text{Revenue}} \times 100$$

- Looks at profit as a percentage of sales turnover
- It shows for every £1 made in sales, how much is left as net profit.
- If this falls from one year to the next or if it is too low, a business may look to reduce its expenses

Mark Up

$$\frac{\text{Gross Profit}}{\text{Cost of Sales}} \times 100$$

- Looks at gross profit as a percentage of sales turnover.
- It shows for every £1 mad

Return on Capital Employed (ROCE)

$$\frac{\text{Net profit before interest and tax}}{\text{Capital Employed}}$$

- Shows the percentage return a business is achieving from the capital being used to generate that return.

F4: Measuring Liquidity

Liquidity ratios measure how solvent a business is. This is how able it os to meet short-term debts.

Current Ratio

$$\frac{\text{Current assets}}{\text{Current liabilities}}$$

- Shows the amount of current assets in relation to current liabilities
- Expressed as x:1
- 2:1 is generally considered acceptable
- 0.5:1 firm would not be able to cover debts with current assets

Acid Test Ratio

$$\frac{\text{Current assets - inventory}}{\text{Current liabilities}}$$

- Tougher measure of liquidity
- Expressed as x:1
- Similar to current ratio but takes out inventory because it is considered to be the hardest current asset to turn into stock quickly

F6: Limitations of Ratios

- Calculated using past data so many not be a reflection of the businesses current situation
- Financial records may have been manipulated and therefore ratios may be calculated on misleading data
- Ratios do not consider qualitative factors
- A ration can indicate an issue in a business but does not tell you what exactly caused the issue or how to solve it
- Comparisons across firms can be difficult because not all businesses report their performance in the same way

F5: Measuring Efficiency

Efficiency ratios tend to be used to assess how well management are controlling the key aspects of a business. They primarily focus on stock and finances.

Trade Receivable Days

$$\frac{\text{Trade Receivables}}{\text{Credit Sales}} \times 365$$

- Measures, on average, how long it takes for debtors to pay
- Expressed as a number of days
- Lower the better as helps with businesses cashflow

Inventory Turnover

$$\frac{\text{Average Inventory}}{\text{Cost of Sales}} \times 365$$

Calculate average inventory by:

$$\frac{\text{Opening inventory} + \text{closing inventory}}{2}$$

- Measures the amount of time stock is held by the business
- Expressed as number of days
- A good number is dependent on the product sold and the market

Trade Payable Days

$$\frac{\text{Trade Payables}}{\text{Credit Purchases}} \times 365$$

- Measures, on average, how long it takes for creditors to pay
- Expressed as a number of days
- Is the gap between the purchase date and payment date of goods and services