BTEC Level 1/2 Tech Award in Enterprise: **Component 3**

A1 Targeting and segmenting the market

Market segmentation is dividing your customers into groups based on them having similar characteristics!

Location
Region
Area
Postcode
Urban
Rural

Geographic

Target customers based on a predefined geographic boundary. Differences in interests, values, and preferences vary dramatically throughout cities, states, regions, and countries.

Demographic

The process of dividing a market through variables such as age, gender, education level, family size, occupation, income, and more. This is one of the most wildly used strategies amongst marketers.

Age
Gender
Race
Religion
Ethnicity
Family size,
Education
Socio economic group

Social class
Attitudes
Lifestyle
Personality

Psychographic

Focus on the intrinsic traits the target customer has. Psychographic traits can range from values, personalities, interests, attitudes, conscious and subconscious motivators, lifestyles, and opinions.

Behavioral

Break down the way customers go through their decision making and buying processes. Attitudes towards the brand, the way they use it, and their knowledge base are all behavioral examples.

Spending
Consumption
Usage
Loyalty
Desired benefits

Why segment a market?

Advantages	**Disadvantages**
Increased sales – design and produce products specifically aimed at groups	Promotional costs might be high – different advertisements and promotions needed for different groups
Helps identify gaps in the market – those not currently being targeted	Cost of market research for that specific group or to find out the market segment
Avoids wasting money – marketing will be focused on that specific group	Lack of information and data – some markets are poorly researched
Higher market share	Hard to reach customer segments sometimes

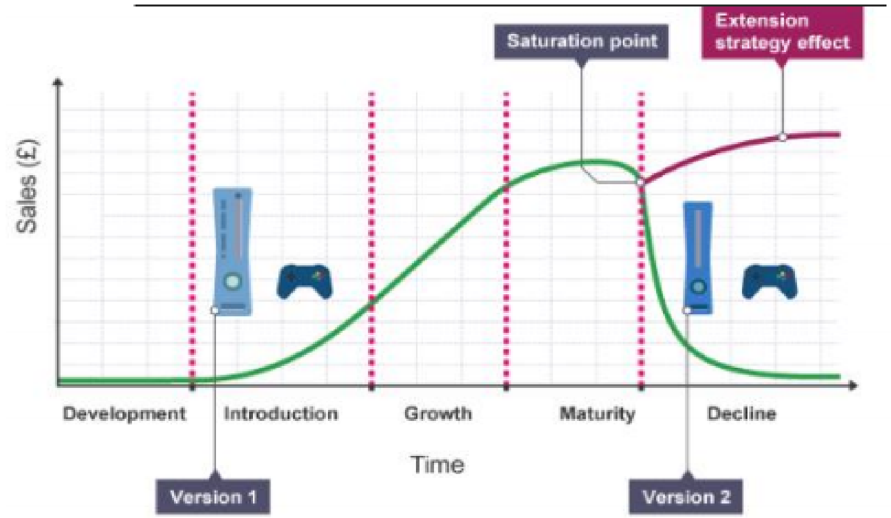
A2

4Ps of the marketing mix

Product

A product is goods or a service that is sold to customer or other businesses. Customers buy a product to **meet a need.**

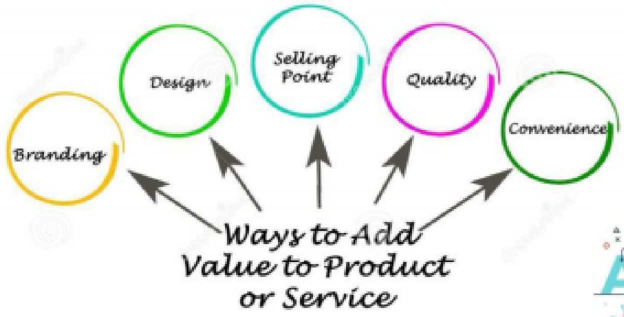
Activity	Meaning
Design	When a business plans what a product will do [its function] and what it will look like [its style]
Invention	When a business comes up with a new product or service
Innovation	When a business improves a product which already exists



1. Introduction Product is new, sales are just beginning	**2. Growth** Sales grow quickly	**3. Maturity** Sales reach their peak	**4. Decline** Sales begin to fall

Product differentiation: Unique Selling Point

- Establishing a **strong brand image**
- Making clear the **unique selling point (USP)**
- Offering a **better location, features, functions, design or selling price** than rival products



Uses of Product Life Cycle
1. Identifies when to introduce extension strategies
2. Identifies when to change marketing techniques/spending
3. Identifies when a product should be discontinued

Limitations of Product Life Cycle
1. Doesn't consider what competitors are doing
2. Doesn't consider social trends and changes in taste
3. Past performance isn't always a good indicator of future performance

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A2

4Ps of the marketing mix

Price

Penetration pricing	When a business is new to a crowded market, they price their products below that of competitors.
Cost plus	The costs of manufacturing plus what profit is wanted created the selling price. COST + PROFIT = COST PLUS PRICING
Promotional	A reduction in the price to attract customers, boost sales or get rid of old stock. 
Skimming	When a business has something new and unique it can set a high price until competition come into the market.
Competitor	When there is a lot of competition, a business will look at what other competitors charge and charge the same.

Why is price important?
- Directly affects revenue
- Must be consistent with the other 3Ps as it will affect the consumer's perception of a good or service
- Wrong decisions can have a serious effect on sales and cash flow

Price Penetration		Cost Plus		Promotional Pricing	
Advantages	**Disadvantages**	**Advantages**	**Disadvantages**	**Advantages**	**Disadvantages**
• Builds customer loyalty • Can help to develop long-term profitability of higher sales and higher market share	• In the short term, it is likely to result in lower profits than if prices were higher • Difficult to raise the selling price in future	• Profit is guaranteed on each item	• If the mark-up is set too high the price may be expensive compared to rivals	• Cash flow and market share improve as sales increase • Can lead to loyal customers as they will trial it	• Customer may only buy when it's on promotion • Brand image may be affected by too many sales
Price Skimming		**Competitor Pricing**		**Loss Leader**	
Advantages	**Disadvantages**	**Advantages**	**Disadvantages**	**Advantages**	**Disadvantages**
• Higher profits straight away • Product may get a reputation for quality encouraging brand loyalty	• Cannot last long as competitors create rival products • More slow sales as its expensive and no more customers can afford it	• Selling prices in line with rivals so should attract customers	• May need other ways to attract customer other than price • Must research competitors - increase costs	• Will attract customers to the business who will hopefully buy other more profitable products	• However if not then the business will not make any profit on these items alone

Promotion

4Ps

Objectives of Promotion

- **To increase sales** – to increase the revenue of the business by obtaining new customers and retaining existing ones. This will satisfy the shareholders and create retained profit for reinvestment into the business.
- **Raise awareness** – some potential customers may not have heard of their products and some existing customers may be unaware of new products that have been introduced.
- **To target specific groups** – aiming their promotion at specific sub-groups in order to encourage sales of particular products. For example, targeting children with the range of products that they have designed for younger customers.
- **To try and beat the competition** – they will attempt to try and persuade customers to switch to purchasing the business' products and thereby increase their market share.
- **To develop/improve the image of the company** – this will raise the brand awareness and give people confidence in the company's products. Corporate advertising.
- **To reassure consumers after the products have been purchased** – this attempts to build confidence in the product hoping that more will then be purchased at a later date.

Promotion

Definition: Promotion is the attempt, through various forms of media, to draw attention to a product and thereby gain and retain customers.

Above-the-line Promotion

Definition: Above-the-line promotion is through independent, mass media, which is indirect and allows a business to reach a wide/large audience.

Methods:

- (Regional) **television** – reaches large audience but expensive
- (Local) **newspapers** – can be kept but may be ignored
- (Local) **radio** – cheap broadcast media but limited coverage – limited audience
- (Local) **magazines** – targeted – colour – kept long time – but limited coverage
- **Billboards** – eye catching but easily missed in busy traffic
- **Cinema** – local/captive audience – can be ignored
- **Website / Internet** – cheap to operate – wider market – may be expensive to set up.

The choice of media used depends on a number of factors:

- **Target market** – who is the business trying to sell to?
- **Whether the objective is to convey information or another type of message** – will the product sell only when consumers fully understand its function, or do people buy on impulse?
- **Cost** – for many small businesses this is the first question they ask about any form of promotion.
- **The reach of the media** – who reads the magazine or watches the adverts? Are they likely to buy the product?
- **The product itself** – is the product suited to a certain type of promotion? For example, is the best way to promote plastic food containers through personal selling door to door or by an advert in the local paper?

4Ps

Below-the-line Promotion

Definition: Below-the-line promotion offers a wide range of alternative promotional strategies. These are often used to support above-the-line promotion. Below-the-line promotion targets consumers directly.

Methods:

- **Direct mailing** – may be targeted – easily ignored
- **Point of sale** – close to customer – may not be seen by busy customer
- **Merchandising/shop window** – relevant to shop – passing trade – but this may be limited
- **Exhibitions and trade fairs**
- **Flyers** – will provide detail – cheap to produce – easy to throw away
- **Personal selling**
- **Packaging**
- **Public relations** (PR)
- **Sales promotion**.

For many consumer products, below-the-line promotion is used only for short-term periods. Offers and promotions come and go quite quickly. However, for other products, such as industrial goods, producer goods and financial services, personal selling plays a long-term strategic role in establishing a relationship with the customer.

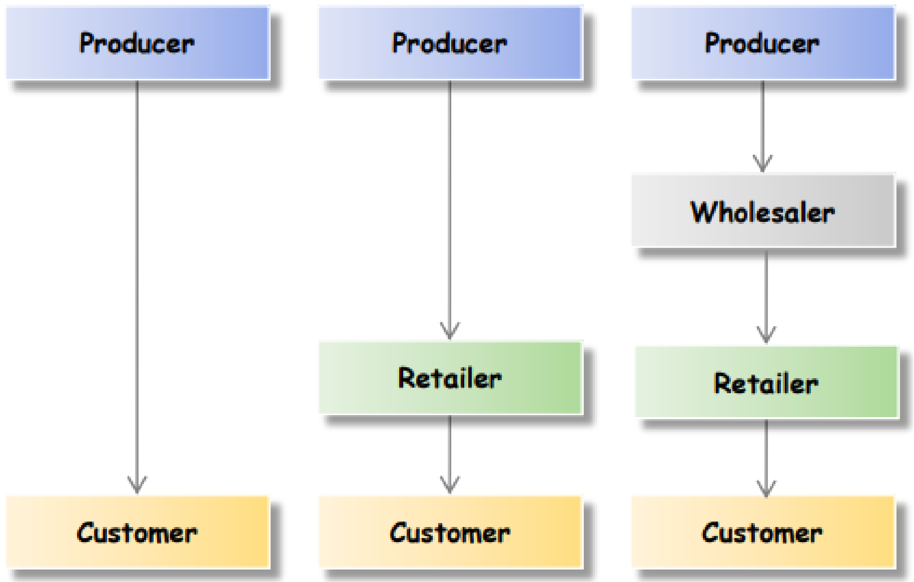
A2

4Ps of the marketing mix

Place

Physical distribution is the movement of goods from the producer to the consumer. There are 3 different physical distribution channels:

knowledge and understanding



Channel 1	by missing out wholesalers and retailers, the producer makes more profit, rather than sharing it with a wholesaler and/or retailer
Channel 2	selling directly to the retailer means the producer can benefit from keeping some of the profit that would have been made by the wholesaler, while being confident the retailer will be able to market the goods to consumers.
Channel 3	a wholesaler can break up bulk stock and offer retailers the goods in the quantities that they can afford, and which they can sell, so, more retailers are willing to sell the goods.

Digital distribution is when the product can be downloaded by the consumer directly from the seller, as in the case of books from Amazon onto a Kindle or music from Spotify onto a MP3 player.

Due to improved technology this has become more popular in recent years.

Advantages	Disadvantages
▪ The consumer can buy the product 24/7 ▪ It is a method of selling, without the costs of a physical shop or transport ▪ The business can sell throughout the world and so has more potential customers ▪ A business may be able to improve its image with skillful use of websites ▪ Less staff may be needed which will cut costs	▪ Physical goods cannot be distributed digitally ▪ It is a very competitive market as consumers can compare prices and products online ▪ Customers who do not own a computer will be unable to buy online ▪ Some customers do not like sharing their bank or credit card details online ▪ Digital content can easily be copied and illegally shared for free online

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A3

Factors influencing the choice of marketing method

1	Is the marketing method **appropriate for the product and brand image?**	The marketing method should reflect the brand image. For example a luxury car maker will advertise in high end magazines and not a newspaper. If the advertising method is not appropriate, it devalues the brand meaning sales may reduce.
2	**Cost** of the marketing method	Enterprises with little funds need to choose wisely what to spend their money on. A new start-up dog walking business is not realistically going to advertise on local radio because of the high cost. They are more likely to use flyers and target local market segments.
3	**Competitors activities**—what are they doing?	An enterprise is likely to see what advertising and promotion their competition are doing. If their competitor is spending lots on advertising then this could mean they attract your customers. The impact of this might be lower sales for your enterprise.
4	**Experience** of the entrepreneur	You may be a skilled and knowledgeable entrepreneur and know your customers well. Put time into this will help your **reputation** and encourages positive word of mouth
5	**Speed and accessibility** of the information—how easy will customers see it?	An entrepreneur will want to push their advertising and promotion quickly to their customers and so **speed** will be a key benefit. Digital media and using social media is

A4

Trust, reputation and loyalty

Reputation is important to an enterprise when the enterprise is trying to attract customers and keep existing customer returning. When this happens, sales usually increase meaning revenue increases and the enterprise will more likely make a profit.

To improve its reputation, an enterprise may engage in these four practices to try and attract customers

Being environmentally Friendly

An enterprise might want to adopt practices that are environmentally friendly like reducing plastic (e.g. fast food outlets of stopped using single use plastic straws).

This shows social responsibility as the enterprise is taking responsibility for their actions. Doing this will appeal to some market segments and might influence some potential customers to buy the goods or services.

Improving Customer Service

Customer service is when a business provides help, support or advice to the people that buy the goods or services.

Good customer service helps keep the brand strong and customers are more likely to make repeat purchases.

Poor customer service can damage the brand and will lead to higher levels of complaints and a lack of trust.

Rejecting Unethical Practice

An enterprise is most wanting to be seen to do the right things. As a result, they are likely to reject unethical practices because using them can damage the brand and perception people have.

For example, using children to promote sugary drinks might be considered unethical and this could cause some customers to

Helping the Community

Lots of enterprises try to improve their reputation by getting involved in their communities through sponsorship, donations and prizes.

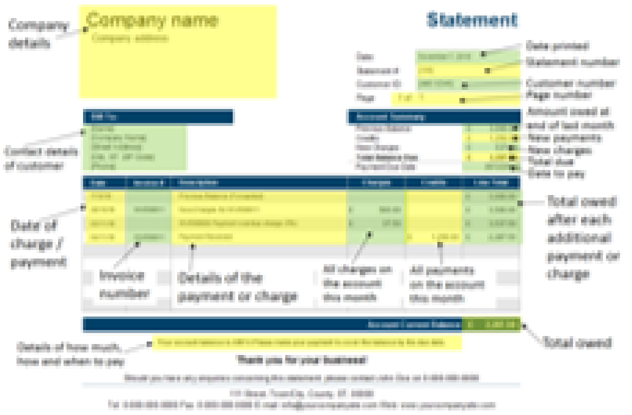
This helps the enterprise because their brand is seen as supporting local people. This will boost the brand image and can help attract potential customers because of this social connec-

FINANCIAL DOCUMENTS

B1

Financial Documents

STATEMENT



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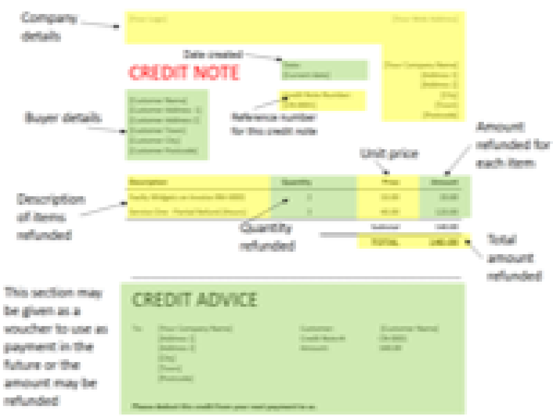
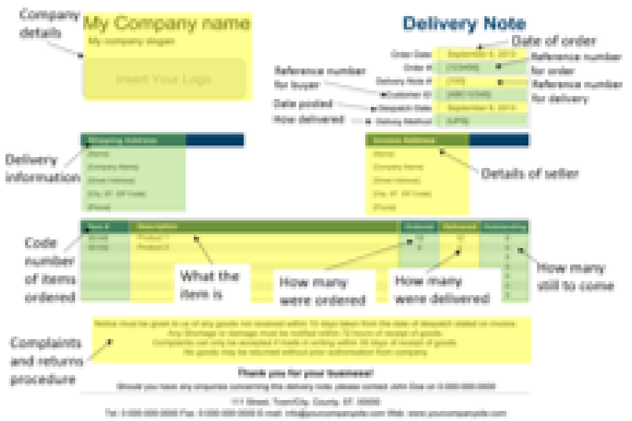
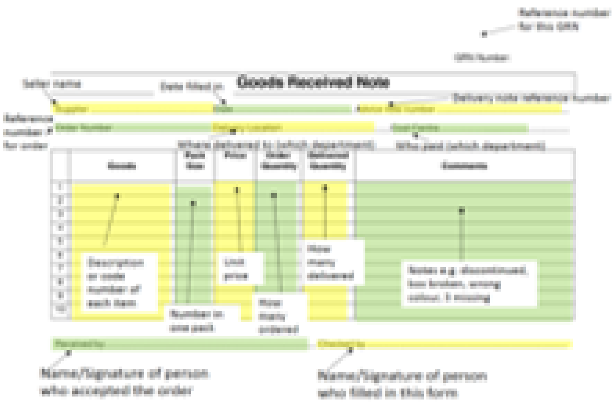


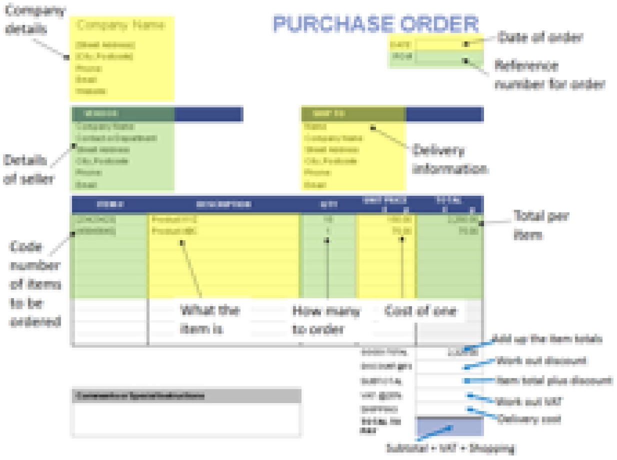
DELIVERY NOTE



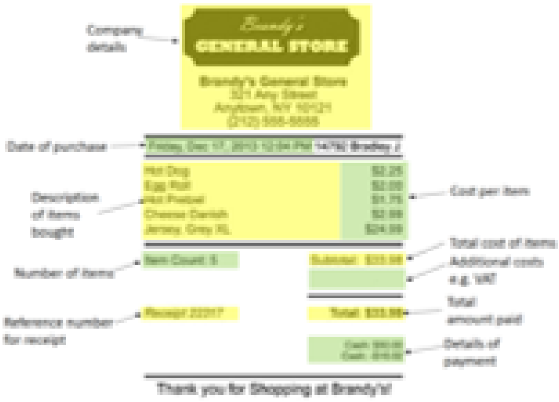
GOODS RECEIVED NOTE



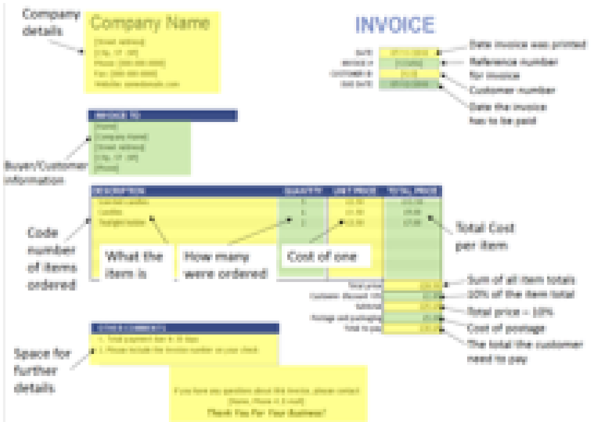
PURCHASE ORDER



RECEIPT



INVOICE



B2 Payment Methods

PAYMENT METHODS

There are 5 payment methods we need to learn for the exam:

1. cash
2. credit cards
3. debit cards
4. direct debit
5. payment technologies

PAYMENT TECHNOLOGIES

Includes technologies such as:

- Electronic (Internet/phone) transfer
- Mobile banking
- Contactless card
- Paym

Advantages	Disadvantages
Increased convenience for the consumer	Some methods only accepted for small transactions
Providing these methods of payment to customers may attract customers who do not hold cash or card-based methods of payment	May have additional setup and operation costs for the enterprise

DIRECT DEBIT

An agreement made with a bank, allowing a third party to withdraw money from an account, on a set day, to pay for goods / services received e.g. gas bill

Advantages	Disadvantages
An easy way to make regular payments	If a mistake is made and too much money is taken, it is consumer's responsibility to claim back the money
The amount paid can be different each month, the payment matches the amount owed	The changing amounts each month can make it difficult for customers to budget

CASH

Notes and coins in a wide range of denominations

Notes : **£5**, **£10**, **£20** and **£50**.

Coins : **1p**, **2p**, **5p**, **10p**, **20p**, **50p**, **£1** and **£2**

Advantages	Disadvantages
Most widely accepted form of payment	Can be lost or stolen
Consumers feel confident using cash	Threat of counterfeit
Makes budgeting easier	Cannot be used online
Easy to set up for the enterprise owner	Less appropriate for large purchases

CREDIT CARDS

Issued by financial institutions e.g. Natwest, Yorkshire building society, Barclaycard

Allows delayed payment of goods & services

Advantages	Disadvantages
Most cards are widely accepted	Interest is charged on balances not paid off within a month
Suitable for online transactions	Interest is charged on cash withdrawals
Offers a degree of protection on purchases	A limit will be set on the amount of credit allowed

DEBIT CARDS

Issued by banks and building societies

e.g. Natwest, Yorkshire building society

Payment for goods and services is deducted directly from a current account

Advantages	Disadvantages
Widely accepted	Customer needs to have the required balance available in the current account
No need to carry cash	
Secure method of payment with low risk of theft	Lower level of fraud protection (than a credit card)
Suitable for online transactions	Loyalty schemes not offered

B3 Revenue and Costs

REVENUE

Revenue is the income received by an enterprise from all sources.

There are 3 main sources of Revenue:

1. Sales
2. Leasing
3. Interest

Sales is the main source of revenue for most enterprises. This is the money that the customers pay for the goods and services that they buy.

Leasing means allowing someone else to use something for a fee. Leasing a part of a premises to another enterprise can provide a source of revenue. Some enterprises specialise in leasing vehicles or equipment to other organisations.

Interest is earned when an enterprise has money in an interest earning account at the bank.

Enterprises also try to think of **Extended Services** they could offer to increase revenue.

e.g. a gym could sell sportswear

FORMULA Revenue = Number sold x Selling price

COSTS

An enterprise needs to spend money in order to make money.

There are 2 main types of cost:

1. Start-up costs (Need to be paid before an enterprise can start trading. E.g. machinery)
2. Running costs (Need to be paid every month to keep the enterprise running. E.g. rent, wages)

RUNNING COSTS

There are 2 types of running cost:

1. Fixed (Not related to how much the enterprise sells E.g. rent)
2. Variable (Related to how much the enterprise sells E.g. Delivery costs)

FORMULA

Variable costs = Number sold x Cost of one unit

Total costs = Variable costs + Fixed costs

B4 Terminology in Financial Statements

Turnover (net sales)	The revenue (money) the enterprise gets from selling your prod-
Cost of sales (cost of goods sold)	How much the enterprise spent on producing the product/service (including raw materials, delivery etc)
Gross profit = Revenue – Cost of	Gross Profit is the amount of profit the enterprise makes from selling products/services, not including any fixed costs.
Expenses –	anything the enterprise spends money on
Net profit = Gross Profit – Ex-	Net Profit is the amount of profit the enterprise makes from selling products/services, after taking off all expenses.
Retained profit	profit the enterprise chose to keep from last year's work, this could
Fixed assets	something worth money, owned by the enterprise, that they will be
Current assets	something worth money, owned by the enterprise, that they will have for less than one year e.g. cash in the bank, stock (they will
Current liabilities	debts the enterprise will pay off in less than one year e.g. trade
Long-term liabilities	debts the enterprise will have for more than one year e.g. mortgage
Debtors –	someone the enterprise is waiting to collect money from e.g. customers who have not yet paid their invoice
Capital	money available to invest in the business usually to buy equipment to start the business or big one off items
Creditors	someone the enterprise owes money to e.g. a supplier that has not
Net current assets	Current assets minus current liabilities

B4 Financial Statements

TERMINOLOGY IN FINANCIAL STATEMENTS

Need to be able to explain the following terms:

Turnover (net sales) - The revenue (money) the enterprise gets from selling your products/services

Cost of sales (cost of goods sold) – How much the enterprise spent on producing the product/service (including raw materials, delivery etc)

Gross profit = Revenue – Cost of Sales. Gross Profit is the amount of profit the enterprise makes from selling products/services, not including any fixed costs.

Expenses – anything the enterprise spends money on

Net profit = Gross Profit – Expenditure. Net Profit is the amount of profit the enterprise makes from selling products/services, after taking off all expenses.

Retained profit – profit the enterprise chose to keep from last year's work, this could be reinvested in the business to expand.

Fixed assets – something worth money, owned by the enterprise, that they will be using for more than one year e.g. premises, vehicle, equipment

Current assets – something worth money, owned by the enterprise, that they will have for less than one year e.g. cash in the bank, stock (they will sell)

Current liabilities – debts the enterprise will pay off in less than one year e.g. trade credit, credit card

Long-term liabilities – debts the enterprise will have for more than one year e.g. mortgage

Debtors – someone the enterprise is waiting to collect money from e.g. customers who have not yet paid their invoice

Creditors – someone the enterprise owes money to e.g. a supplier that has not been paid yet

Net current assets – Current assets minus current liabilities

Capital – money available to invest in the business

STATEMENT OF COMPREHENSIVE INCOME

Shows the profit or loss of an enterprise over time.
They are sometimes called ***Profit and Loss Accounts*** or ***Income Statements***.
Gross Profit **and** *Net Profit* will be calculated.

FORMULA

Gross Profit = Revenue – Cost of sales
Net Profit = Gross Profit – Expenditure

	£	£
Income from sales		40,000
Cost of sales	10,000	
Gross Profit		30,000
Expenses		
Wages	13,000	
Electricity	2,000	
Net profit		15,000

STATEMENT OF FINANCIAL POSITION

Shows the financial performance of an enterprise at a point in time.
They are sometimes called ***Balance sheets***.
What the enterprise **owes** and **owns** will be included.

A Statement of Financial Position includes:

Assets – what the enterprises owns and any money owed to it

Liabilities – what the enterprises owes to others

Capital – how the enterprise is funded

FORMULA

Total Assets = Fixed Assets + Current Assets
Working Capital = CA – CL (current assets – current liabilities)
(Also called Net Current Assets)
Net Assets = TA – TL (total assets – total liabilities)

ASSETS		
Fixed Assets		
Equipment	£4,802.62	
Vehicle	£225.00	£5,027.62
Current Assets		
Cash in bank	£22,385.26	
Debtors	£2,400.00	
Stock	£1,500.00	£26,285.26
Total Assets		£31,312.88
LIABILITIES		
Current liabilities		
Creditors	£900.00	
Overdraft	£500.00	£1,400.00
Working capital		£24,885.26
Long-term liabilities		
Loan		£519.72
Net Assets		£29,393.16
CAPITAL ACCOUNT		
Opening capital	£8,330.83	
Share capital	£19,000.00	
Retained Profit	£2,562.33	
Drawings	-£500.00	
Closing capital		£29,393.16

Net assets and Closing capital should be the same if the Statement of Financial Position is **balanced**

B5 Profitability and Liquidity

PROFITABILITY	LIQUIDITY
Profitability is a measure of the profit of an enterprise in relation to another factor. It gives a more accurate of the position of the enterprise by comparing one figure to another. There are 2 profitability ratios to learn: 1. Gross profit margin (GPM) 2. Net profit margin (NPM)	Liquidity measures an enterprise's ability to meet short-term cash payments Liquidity ratios measure how solvent an enterprise is (how easily it can meet short term debts) There are 2 liquidity ratios to learn: 1. Current ratio 2. Liquid capital ratio
GROSS PROFIT MARGIN **Gross Profit = Revenue – Cost of sales** $\text{Gross Profit Margin percentage} = \frac{\text{gross profit}}{\text{revenue}} \times 100$ This ratio looks at gross profit as a percentage of turnover. It shows us, for every £1 made in sales, how much is left as gross profit after the cost of goods sold has been deducted. A gross profit of 88% means, for every £1 of sales 88p is left as gross profit.	**CURRENT RATIO** $\text{Current Ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$ A current ratio of 3 means an enterprise has 3 times as many current assets as current liabilities. For every £1 of short-term debts owed, it has £3 of assets to pay them. The ideal ratio is **1.5**. If the current ratio is less than 1 the enterprise will struggle to pay its debts.
NET PROFIT MARGIN **Net Profit = Gross Profit – Expenditure** $\text{Net Profit Margin percentage} = \frac{\text{net profit}}{\text{revenue}} \times 100$ This ratio looks at net profit as a percentage of turnover. It shows us, for every £1 made in sales, how much is left as net profit after all of the expenses have been deducted. A net profit of 32% means, for every £1 of sales 32p is left as net profit.	**LIQUID CAPITAL RATIO** $\text{Liquid Capital Ratio} = \frac{\text{Current assets - Inventory}}{\text{Current liabilities}}$ This ratio removes inventory from the calculation because stock could be difficult to quickly turn in to cash to pay off a debt. The ideal ratio is **1**. If an enterprise has less than this it will struggle to pay its debts.

DIFFERENCE BETWEEN CASH AND PROFIT

Cash is the amount of money currently or soon-to-be available.
It is the money coming into the enterprise.
Liquidity is all about how much **cash** the enterprise has available

Profit is the amount of money left over after all expenses are paid.
Remember: profit = revenue – expenditure
Profitability is all about how much **profit** the enterprise is making

A successful enterprise needs both **cash** and **profit** to grow over time.

C1 to C3

Budgeting and Cash flow

CASH
Cash is the liquid assets of the business
This includes:
* Bank balance
* Other cash in the business

CASHFLOW
Cash flow is the money flowing in and out of a business
There are 2 types of cash flow
1. Inflows (money in to the business)
   e.g. payments from customers
2. Outflows (money going out of the business)
   e.g. paying bills

NEGATIVE FIGURES
If any figure is a negative number, then it can be shown with a minus sign or between brackets
e.g. -4500 OR (4500)

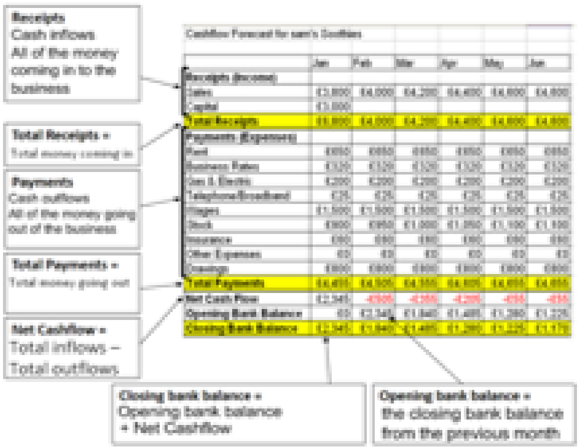
LIQUIDITY
Positive cash flow is when the inflows are greater than the outflows.
This is called positive liquidity.

Negative cash flow occurs when the outflows are greater than the inflows.
This is called negative liquidity.

CASH FLOW STATEMENTS AND FORECASTS
A **cash flow statement** shows the cash inflows and cash outflows over the past 12 months.
These are produced by limited companies.

A **cash flow forecast** shows the anticipated cash inflows and outflows over a period of time and the **net cash flow**.

LAYOUT OF A CASH FLOW FORECAST



BENEFITS AND RISKS OF CASH FLOW FORECASTING

Benefits of cash flow forecasts	Risks of not using cash flow forecasts
The timings of all expected cash inflows are known	Revenue may be received late or not at all
Reminders can be sent for any debts that are owed/overdue	Payments may be delayed
The timings of all cash outflows are known	Suppliers may become frustrated and could refuse to trade with the enterprise in the future
Payments can be renegotiated if there is a problem	The enterprise may have to pay high interest charges on an unauthorised overdraft or emergency loan
If there is likely to be a deficit, the owner has time to take action to delay payments, or obtain a temporary loan	The enterprise may not be able to pay its bills and eventually might have to cease trading
The owner has warning of there is a long-term problem, which means costs can be reduced and/or revenue increased to help the enterprise to survive	

REASONS FOR CASH FLOW PROBLEMS
The enterprise may not use cash flow statements or forecasts
Overtrading (growing too quickly without enough funds)
Debtors may not pay on time
All bills might be due at the same time
Unexpected payments
Poor cash flow management
(e.g. poor record-keeping or not chasing debtors)

ANALYSING A CASH FLOW FORECAST
The most important figure is the closing bank balance
Unless a business has an overdraft they should not have a negative closing balance
A small positive number means the enterprise can continue to trade and pay bills
A small negative number means money may have to be borrowed
A large negative number means the enterprise may have to close unless action is taken

ACTIONS TO IMPROVE CASH FLOW
Cutting costs
Increasing revenue
Reducing stock levels
Delaying payments
Reducing credit periods
Making an early payment bonus
Selling assets
Managing debt
Delaying expansion plans

WHY FORECAST?
Enterprises need to be able to forecast cash flow to enable them to make business decisions.

This is important to make sure all expenses will be covered.

C4

Break Even Analysis

BREAK EVEN

Break even is when revenue and expenditure are exactly the same.
There is £0 profit.
There are 2 ways to calculate the break even point;

1. Break even formula
2. Break even chart

BREAK EVEN POINT

The Break Even Point (BEP) is the number of items the business needs to sell (or customers they need to serve) to cover all of their costs and make exactly £0 profit.
BEP is NOT money.

BREAK EVEN FORMULAE

$$\text{Break-even point} = \frac{\text{fixed costs}}{\text{selling price per unit} - \text{variable cost per unit}}$$

MARGIN OF SAFETY

The Margin of Safety is the difference between the Break Even Point and the current number of sales.

Margin of safety = Number sold – Break even point
It is useful because it reduces risk because you actually sell more than the BEP so it provides a sales safety net where sales can reduce but the business still makes a profit if above BEP. Secondly, it allows a safety net for the business to lower or increase the selling price to see what impact this might have on sales.

IMPORTANCE OF BREAK EVEN

Break-even is an important calculation.
This is because it tells the owners of an enterprise exactly how many products they must produce and sell before they can start to make a profit
The benefit of using a break-even analysis is that it allows the owner to answer 'What if…' questions:
What if we were able to sell an extra 200 units?
What if rent went up by £80 per month

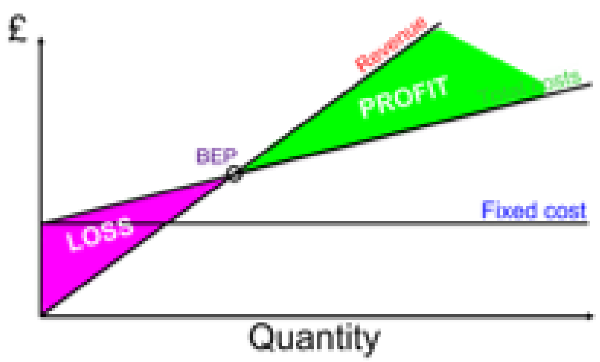
VALUE AND IMPORTANCE OF BREAK EVEN ANALYSIS

Benefits of break-even analysis	Risks of not completing a break-even analysis
Both the fixed and variable costs are known	Costs are unknown and/or too high
Projected sales revenue is calculated	The selling price is set too low or too high
The entrepreneur knows how many products must be sold to make a profit	The entrepreneur has no idea how many items must be sold to make a profit
The entrepreneur can make adjustments to try to make a profit sooner	The enterprise make a loss over a long period of time without any action being taken
The margin of safety is known	The margin of safety is unknown
The best goods are stocked and sold at the optimum price so the enterprise is successful	Stock costs too much, is sold at the wrong price (maybe less than cost price) and the enterprise fails

LIMITATIONS OF BREAK EVEN ANALYSIS

The model is a simplification
It assumes variable costs increase constantly (ignoring the possibilities of negotiating lower prices for purchasing large quantities of raw materials)
Assumes the firm sells all of its output at a single price (in reality firms offer discounts for bulk purchases)
Assumes all output is sold (In times of low demand, a firm may have difficulty selling all it produces)

BREAK EVEN CHART



START-UP FINANCE

The money that enterprise owners will use to create their businesses is known as start-up finance.
Some people use their own money and others will use external sources (such as a bank loan)
Starting an enterprise is expensive and it will be some time before the start-up costs are repaid.

C5

Sources of business finance

FINANCE FOR GROWTH

If an enterprise is successful, the owners might decide to expand, such as:
Selling more products
Opening a new branch
Moving in to new markets
(Sources of finance for growth could be the same as start-up finance, but retained profit could also be used)

WORKING CAPITAL : DAY-TO-DAY FINANCE

Working capital is the money an enterprise needs to run from day to day, paying for things such as:
* Stock
* Bills
* Wages

INTERNAL SOURCES – ADVANTAGES & DISADVANTAGES

Finance method	Explanation	Benefits	Drawbacks
Retained profit	• Money kept in the business by the owners • Known as retained profit on the statement of financial position	• No interest to pay	• Could have been invested elsewhere, earning an higher profit • Business may not have enough retained profit to meet its needs • Shareholders may become unhappy if this means lower dividend payments
Owner funds	• Money put in to the business by the owner	• No interest to pay • Banks are more willing to lend money if the owner has put their own money in to the enterprise	• Could have been invested elsewhere, earning an higher profit • Owner may not have enough funds to meet the needs of the business
Selling assets	• Items owned by the business are sold and the money made is used to finance business growth or working capital	• No interest to pay • The business is using money it already has – so it won't need to take on any loans	• The business has to have something worth selling • They may sell something they need later

RETAINED PROFIT (INTERNAL)

A major source of long-term finance
Shareholders of a business will share most of the profit and the retained profit is the amount of profit that is not shared out. (It is kept in the business)

PERSONAL SAVINGS (INTERNAL)

The business owners own money
Could be referred to as owner funds
Low risk

SALE OF ASSETS (INTERNAL)

An enterprise might sell some of the assets they own (premises, vehicles) to raise money.
When funds are low, sale of assets can free up cash to pay off debts and buy stock.

SHORT-TERM EXTERNAL– ADVANTAGES & DISADVANTAGES

Finance method	Benefits	Drawbacks
Overdraft	• Very quick to arrange • Good short-term solution to cash flow problem	• Interest is paid • Only suitable for small amounts • Has to be repaid within a short amount of time
Credit card	• No interest to pay if balance is settled within the month • Flexible access to credit as required	• High rates of interest • Limit on the amount of credit
Trade credit	• Gives the business more cash to use in the immediate future	• Can only be used to buy certain goods • Bills usually have to be settled within 30, 60 or 90 days

CREDIT CARDS (SHORT-TERM EXTERNAL)

A common source of finance for small enterprise
The card has a credit limit (eg £3000) and the owner can spend up to that amount
They pay interest on the balance of the credit card
If the total amount if paid back within the month no interest is charged
Each month the owner will pay off some money

OVERDRAFT (SHORT-TERM EXTERNAL)

Used for start-ups and small businesses
An overdraft is a loan facility
The bank let the business owe it money when its bank balance goes below zero
The bank charges interest (often at a high rate)
A flexible source of finance only used when needed

TRADE CREDIT (SHORT-TERM EXTERNAL)

One of the main sources of short-term finance
Raw materials can be purchased on credit with payment terms between 30 and 90 days
It is an interest-free short-term loan
Allows business to receive the revenue from goods sold before having to pay suppliers

LOANS (LONG-TERM EXTERNAL)

An agreed amount of money that will be paid back over a period of time
Enterprise owners need to apply for the bank loan, proving they can repay the loan
Interest will be added to the monthly repayments (you pay back more than you borrowed)

HIRE PURCHASE (LONG-TERM EXTERNAL)

Hire purchase allows a business to use expensive assets, such as machinery, without paying the whole cost up front
Regular amounts of money paid to the supplier
When they have paid the total cost of the equipment, it belongs to them

LEASING (LONG-TERM EXTERNAL)

Leasing allows a business to use expensive assets, such as machinery, without having to buy them
A business pays regular amounts of money to borrow the equipment from the company that owns it
Return the equipment when finished with it

GOVERNMENT GRANTS (LONG-TERM EXTERNAL)

Grants can come from local or national government
They are incentives to support the growth of enterprise that have a positive impact on the economy, such as: providing a social benefit, creating jobs in high unemployment areas