



## Finance and support for a small business

Caption question

Textbook p. 52

### A corner shop

If you were starting a business similar to the one in the photograph, what would you need to buy before you could start trading?

Answers might include:

- a lease on the shop that is the right to rent it for an agreed period
- fridges and freezers to keep food fresh
- a till to record takings and a safe to keep money in
- stock to sell in the shop, e.g. food and tobacco
- possibly a delivery van

Caption question

Textbook p. 53

### Branch of the Cooperative bank

Banks often think that new businesses are risky (that is likely to fail) and may be unwilling to lend them money. Why do banks consider many new businesses to be risky?

Answers might include:

- because the business does not have established customers
- entrepreneurs may not have a lot of experience or knowledge of the industry
- new businesses can be short of money and therefore cannot survive difficult times
- competitors may respond to their entry into the market by cutting prices or increasing advertising

Caption question

Textbook p. 55

### Large family group

Why might an entrepreneur be worried about borrowing a large sum of money from a family member to start a new business?

Answers might include:

- The family may demand repayment at short notice if they find themselves short of money.
- Families may argue and this can lead to demand for immediate repayment.
- Friends and family may not have enough money to give a large enough loan.
- An entrepreneur may be concerned that if the business fails he or she may not be able to repay friends and family.
- If a bank is not prepared to lend money (and the entrepreneur has to borrow from friends/family) it may be that the business idea is not a good one.



Using data

Textbook p. 56

Ben is planning to start a hairdressing business. He needs to raise £50,000 and plans to raise his finance in the following ways:

Owners' funds	£15,000
Loan from his father	£18,000
Bank loan	£?

## Questions

- (i) How much will Ben need to borrow from the bank?  
(ii) What percentage of his finance is Ben's father putting into the new business?

Answers are:

- (i) The bank loan will be  $£50,000 - (£15,000 + £18,000) = £50,000 - £33,000 = £17,000$ .  
(ii) Ben's father is contributing  $\frac{£18,000 \times 100}{£50,000} = 36\%$

Business insight

Textbook p. 58

### Northeast firms to get boost

Almost £2 million of finance from the European Union has been given to the Institute of Digital Innovation (IDI) to help start 90 new companies in the northeast of England. Further finance has been given by the UK government and the University of Teesside in Middlesborough. The IDI project aims to help:

- entrepreneurs to start high technology businesses
- university graduates make a business out of their ideas

The IDI not only provides finance but also offers expert advice to those planning to start up a new business.

Source: [www.smallbusiness.co.uk](http://www.smallbusiness.co.uk)

## Question

Why might university graduates find it difficult to raise finance to start a new business?

Answers might include:

- they are likely to have little or no experience of starting and managing businesses
- they may not have much of their own money to invest into a new business
- they will not have a history of having repaid other loans successfully

Quick questions

Textbook p. 59

- 1 What is a source of finance? (2 marks)
- A source of finance is someone or somewhere from which an entrepreneur can raise money (usually to start a business).



- 2 Explain, with the aid of examples, what is meant by the term owners' funds.** (5 marks)
- The term owners' funds means the money put into a business by its owner or owners. This might be in the form of shares if it is a company or simply a loan in the case of sole traders or partnerships.
- 3 What is the difference between a bank loan and an overdraft?** (4 marks)
- A bank loan is for a fixed amount over a definite period. For example, a bank loan might be for £15,000, which is to be repaid, with interest, over 4 years. An overdraft is a flexible loan up to an agreed amount, which a business might or might not use depending on circumstances. This may not have a stated period.
- 4 State one advantage and one disadvantage of using an overdraft as a source of finance.** (2 marks)
- Advantages:
    - it is flexible — a business only uses it when it is needed
    - because it may only be used occasionally it may be cheaper than a bank loan
  - Disadvantages:
    - the interest rate charged on overdrafts can be high, especially for new businesses
    - the bank may withdraw the overdraft facility at short notice
    - it may be difficult for a new business to persuade a bank to give it an overdraft
- 5 Describe a mortgage.** (3 marks)
- Mortgages are loans from banks and building societies that are used to buy land and buildings such as offices and shops. Mortgages are normally long-term loans of up to 30 years. The amount of money borrowed is normally large because land and buildings are usually costly.
- 6 State two reasons why an entrepreneur might decide to borrow money from friends and family.** (2 marks)
- it can be easy to arrange, especially if friends and family are wealthy
  - it may be that no interest is charged on the loan
- 7 Can an entrepreneur start a business by only using a government grant as a source of finance? Explain your answer.** (4 marks)
- no, government grants will only cover part of the money required. It is usual for an entrepreneur to have to put in a sum of money equal to the amount of the government grant
- 8 Name the government organisation, sponsored by Lloyds TSB, which offers advice and guidance to entrepreneurs.** (1 mark)
- it is an organisation that operates a website: [www.smallbusiness.co.uk](http://www.smallbusiness.co.uk)
- 9 State three ways in which a bank might support an entrepreneur starting a new business.** (3 marks)
- help with writing business plans
  - advice on starting a business in specific industries such as food retailing
  - how to find suitable buildings for your business
  - advice on employing people
  - how to operate a website for the business
- 10 Describe the advice and support that an entrepreneur might receive from:**
- (i) **an accountant**
- (ii) **a solicitor** (4 marks)
- Accountants offer advice on financial matters such as taking out loans and paying taxes.
  - Solicitors offer help on legal issues such as signing a contract with a supplier or a franchise agreement.



Section assessment

Textbook pp. 59–60

**Haven**

Peter Miller is only 19, but has set up his own recording studio called Haven in a small village in Cumbria. Peter turned down several job offers after university to start his business. He is a skilled musician, but needed help to start his business. In particular, Peter had to raise £25,000. The finance was needed to pay for a year's rent on a suitable building, to buy equipment and to pay for advertising. Peter asked his family to lend him £12,500 and managed to gain a small government grant (£2,500). He decided to take out a bank loan for the rest, preferring not to have an overdraft. He found it difficult to persuade a bank to lend him money, as he had not drawn up a business plan.

**Questions**

**1 Define the term 'overdraft'.** (2 marks)

- it is a flexible loan that a business can use when necessary

Award 1 mark for the notion of a loan and the second mark for some development such as its flexibility.

**2 Describe two organisations that might have helped Peter to start his business.** (4 marks)

Level	Descriptor	Mark
2	Candidate offers description	3–4
1	Candidate identifies relevant organisations	1–2

Answers might include:

- Business Link may have offered a wide range of general advice through its website
- [Smallbusiness.co.uk](http://Smallbusiness.co.uk) may have provided a similar service
- a bank might give more specific advice on planning his business
- accountants and solicitors may offer specific financial and legal advice

**3 Explain why Peter might have chosen to take out a bank loan.** (6 marks)

Level	Descriptor	Marks
2	Candidate explains relevant reason(s)	3–6
1	Candidate identifies relevant reasons	1–2

Answers might include:

- Peter had raised a high proportion of the money in other ways and this might have helped to persuade the bank to grant a loan.
- Peter could remain in sole control of his business by taking out a bank loan.
- The amount of money that he needed to raise was not too large.

**4 Would drawing up a business plan have made it easier for Peter to raise finance?**  
Give reasons for your answer. (8 marks)

Level	Descriptor	Marks
2	Candidate explains relevant point(s)	5
1	Candidate states relevant points	1–3



In addition use the grid below to award marks for evaluation (AO3).

Level	Descriptor	Marks
3	Candidate offers judgement with justification	5–6
2	Candidate offers judgement with some justification	3–4
1	Candidate offers unsupported judgement	1–2

Answers might include:

**For a business plan**

- if Peter wants a bank loan this will be essential
- it will help Peter to judge whether his business is likely to succeed
- it would give Peter something against which to monitor his first months of trading

**Against a business plan**

- Peter may not have decided to take out a bank loan
- this is a small business and he may not think he needs a plan

**Extension exercise**

**Do you think that Peter raised his finance in the right ways? Give reasons for your answer.** (9 marks)

Level	Descriptor	Marks
2	Candidate explains relevant point(s)	2
1	Candidate states relevant points	1

In addition use the grid below to award marks for evaluation (AO3).

Level	Descriptor	Marks
3	Candidate offers judgement with justification	6–7
2	Candidate offers judgement with some justification	3–5
1	Candidate offers unsupported judgement	1–2

Answers might include:

**For Peter's methods of raising finance**

- borrowing 50% of the capital from his family would have been relatively cheap
- borrowing from family is easy to arrange
- a government grant may not have to be repaid
- a bank loan might have been preferable to an overdraft because it is less likely to be withdrawn

**Against Peter's methods of raising finance**

- Peter's family may ask for the £12,500 back at short notice
- his family may not have assessed his business idea and offered advice
- it was not sensible to expect to arrange a bank loan without drawing up a business plan



# Financial terms and simple calculations

## Caption question

Textbook p. 61

### A fruit stall

Why might the owner of a fruit stall decide to reduce prices towards the end of the day?

Answers might include:

- the owner may not want to take any of the stock away at the end of the day
- the stock is perishable and will be worthless in a day or two
- he or she may need cash to pay suppliers

## Caption question

Textbook p. 63

### A small hotel

What start-up costs might an entrepreneur have to pay if she took over the hotel in the picture?

Answers might include:

- the purchase of the building
- refurbishing and decorating costs
- purchasing new equipment such as cookers, computers and tills
- the costs of researching the market
- costs of recruiting new staff

## Business insight

Textbook p. 64

### Fusion Systems

Carl Bradley runs a computer shop called Fusion Systems with his wife in Eastbourne, East Sussex. He employs three people and the business has an annual revenue of £540,000. In December 2008 Carl said that his business's sales had fallen and therefore the business was receiving less revenue. Carl is hoping to see his costs fall, especially his fixed costs.

Source: *BBC News*, 18 December 2008

## Question

What will have happened to Fusion Systems's profits in December 2008? What might Carl do in response?

Answers might include:

- The business's profits are likely to have fallen unless its costs fell too.
- It may be that the business made a loss depending on the balance between total costs and revenue.
- Carl could reduce costs as he suggests; perhaps not employ so many staff or buy less stock.
- Carl could try to increase sales again by, for example, advertising more.
- Carl should really try to find out why the business's sales fell.



Using data

Textbook p. 65

Price per pot	Revenue
£12	£1,200
£15	£1,500
£20	£2,000
£25	£2,500
£30	£3,000

Price and revenue for a potter who sells 100 pots each month.

## Question

Suppose that a price of £20 per pot will lead to the business selling 85 pots each month and a price of £30 will cause monthly sales to fall to 72 pots. Calculate the business's revenue in each of these cases.

Answers are:

- at £20 per pot revenue =  $85 \times £20 = £1,700$
- at £30 per pot revenue =  $72 \times £30 = £2,160$

Business insight

Textbook p. 67

### Internet success

Holly Tucker and Sophie Cornish are managing the rapid growth of [Notonthehighstreet.com](http://Notonthehighstreet.com), the business they set up 2 years ago. Last year the business's revenue was approximately £800,000 and the partners expect it to rise to £3.5 million this year. Holly and Sophie are not satisfied, however, and are planning to expand their business. Notonthehighstreet sources good-quality clothes and gifts from small producers and sells them online. Holly says, 'We provide an opportunity for thousands of independent suppliers to sell their products. Sites like ours are acting as a kind of shop window for the long tail of the internet.'

Source: *The Times Online*, 27 July 2008

## Question

Would you expect the business's profits to be higher than last year? Explain your answer.

Answers might include:

- The partners expect their business's revenue to rise to £3.5 million this year so profits should be higher.
- It depends what happens to the business's costs. They may spend money expanding the business and this could reduce next year's profits.

Quick questions

Textbook p. 67

**1 Explain the difference between sales and revenue, using examples.**

(4 marks)

- Sales is the quantity or number of products sold by a firm. Revenue is the amount of money received from selling these products. So a car manufacturer might sell 1,500 cars in a month and receive a revenue of £27 million from the sales of the cars.



- 2 Give an example of a fixed cost and a variable cost.** (2 marks)
- Rent and rates are examples of fixed costs, they do not alter when a business produces more or less output. Buying fuel and raw materials are examples of variable costs, these costs rise and fall along with the level of output.
- 3 Give the formula used to calculate a business's revenue.** (2 marks)
- revenue = selling price × sales (number of products sold)
- 4 If a business increases its price and sales are unchanged, explain what will happen to its revenue.** (3 marks)
- Its revenue must rise. This is because it is selling the same number of products but each one is sold at a higher price. For example, if a farm shop sells 80 bags of potatoes in a week at £3 a bag it will have revenue of £240. However, if it increases the price to £4 and sales remain at 80 bags per week, its revenue from selling the potatoes will rise to £320.
- 5 Explain what would normally happen to a business's sales if it increases its price.** (4 marks)
- A business would normally expect its sales to fall. Some consumers might decide that the product is too expensive and either not buy it all or buy from another business whose prices are lower. If the business has many competitors then it might lose many sales.
- 6 Give the formula used to calculate a business's profits or losses.** (2 marks)
- profits (or losses) = revenue – total costs
- 7 If a business's total costs are higher than its revenue, will it make a profit or a loss?** (1 mark)
- the business will make a loss
- 8 A business has a selling price of £2.50 and sales of 5,000 products each month. Calculate the business's monthly revenue.** (3 marks)
- revenue = selling price × sales (number of products sold)
  - revenue = £2.50 × 5,000 = £12,500 per month
- 9 A manufacturer's products each have a variable cost of £25 and the business produces 250 each month. The business's fixed costs are £2,000 per month. Calculate its total costs for a month.** (4 marks)
- total costs = fixed costs + variable costs
  - total costs (per month) = £2,000 + (£25 × 250) = £2,000 + £6,250 = £8,250.
- 10 A business has variable costs of £500 each week and its fixed costs are £750 over the same period. Its sales are 250 units each week and the price of its products is £8. Calculate the business's weekly profits.** (5 marks)
- profits = revenue – total costs
  - profits = (£8 × 250) – (£750 + £500) = £2,000 – £1,250 = £750 each week

### Section assessment

Textbook p. 68

#### Nigel's Honey

With an inheritance from his father, Nigel Gilpin set up a business at his home to produce and sell honey. Nigel gave up a well-paid job to start his business. At first, he did not think that his sales were high enough to make a profit, but since then he believes that his business has become profitable. Nigel has gathered together his costs and revenues and is about to calculate his business's profits for the past year — or was it a loss? Nigel thinks that if his business has made a loss over the year the



answer is easy: increase the price of a jar of his honey. If he does this he thinks his business would be certain to make a profit.

Variable costs per jar of honey	£1.00
Annual fixed costs	£1,500
Selling price per jar of honey	£2.25
Sales over the year	2,500

## Questions

**1 Define the term 'sales'.** (2 marks)

- Sales is the number of products sold by a business over a time period.

Award 1 mark for the idea of selling and the second mark for reference to number or quantity that is sold.

**2 Explain the difference between a profit and a loss.** (4 marks)

Level	Descriptor	Marks
2	Candidate explains difference by defining/explaining both	3–4
1	Candidate defines profits or losses	1–2

Answers might include:

- a profit is earned when a business's revenue is greater than its total costs
- if total cost is a larger figure than revenue the business will make a loss

**3 Using the figures above, calculate Nigel's profit or loss for the year.** (6 marks)

- variable costs per jar of honey: £1.00
- annual fixed costs: £1,500
- selling price per jar of honey: £2.25
- sales over the year: 2,500
- profit = revenue – total cost
- profit =  $(£2.25 \times 2,500) - (£1.00 \times 2,500) + £1,500 = £5,625 - (£2,500 + £1,500)$
- so, profit =  $£5,625 - £4,000 = £1,625$

Award 2 marks for correct revenue figure and 2 marks for correct total cost figure. Award 5 marks if the candidate makes an error when bringing these figures together. Award 6 marks for a correct answer.

**4 Do you think that Nigel is right to believe that increasing his price is a certain way to make a profit? Give reasons for your answer.** (8 marks)

Level	Descriptor	Marks
2	Candidate explains relevant point(s)	2
1	Candidate states relevant points	1

In addition use the grid below to award marks for evaluation (AO3).

Level	Descriptor	Marks
3	Candidate offers judgement with justification	5–6
2	Candidate offers judgement with some justification	3–4
1	Candidate offers unsupported judgement	1–2



Answers might include:

**For increasing his price**

- a rise in price could give Nigel more revenue
- this will increase his profits as his costs will not rise unless he sells more

**Against increasing his price**

- a rise in price will almost certainly mean that his sales fall
- the fall in sales might reduce his revenue and this could mean he makes a loss
- he might not be able to sell all of the honey he has produced. This could make his profits smaller

**Extension exercise**

**Would it matter if Nigel's business did not make a profit during its first year of trading? Give reasons for your answer.** (9 marks)

Level	Descriptor	Marks
2	Candidate explains relevant point(s)	2–3
1	Candidate states relevant points	1

In addition use the grid below to award marks for evaluation (AO3).

Level	Descriptor	Marks
3	Candidate offers judgement with justification	6–7
2	Candidate offers judgement with some justification	3–5
1	Candidate offers unsupported judgement	1–2

Answers might include:

- No, it would not matter because:
  - many businesses do not make a profit during their first year — sales should improve over time
  - Nigel has an inheritance to help him out financially
  - Nigel has had a well-paid job and should have some savings he can draw on
- Yes, it would matter because:
  - Nigel has given up his well-paid job and may not have any other earnings
  - if the business makes a loss, he will have to find the money to pay this — does he have it?

## Using cash flow

Caption question

Textbook p. 69

### Delivery van

**Buying a van can cause a major cash outflow for a business. Why might a new business choose to lease (rent) a van?**

Answers might include:

- A leased van would only result in a small payment each month — this would reduce and delay cash outflows.



- Any faults would be repaired by the business that owned the van — this would avoid any further large outflows of cash.

**Caption question**

Textbook p. 70

**House builders**

**Why might house builders experience a large time gap between cash outflows and cash inflows?**

Answers might include:

- Houses can take a long time to build — sometimes more than a year, so builders have to wait a long time for payment.
- It can take some time to sell houses, so again this means that house builders have to wait to receive inflows of cash.

**Interpreting Peter and Sue’s cash flow statement**

Textbook p. 72

Below is the cash flow statement for Peter and Sue’s restaurant after its first month of trading in December.

	<b>December</b>
<i>Cash inflows</i>	
Peter and Sue’s savings	5,000
Bank loan	7,500
Sales revenue from Sue’s	4,200
<b>Total cash inflow</b>	<b>16,700</b>
<i>Cash outflows</i>	
Purchase of stocks of food and drink	7,900
Wages	4,100
Interest on bank loan	250
Rent (for three months)	4,250
Electricity and gas	220
<b>Total cash outflow</b>	<b>16,720</b>
<b>Net cash flow</b>	<b>(20)</b>
<b>Opening balance</b>	<b>1,000</b>
<b>Closing balance</b>	<b>980</b>

**Do you think Peter and Sue would be pleased with the information given in this cash flow statement? Why?**

Answers might include:

- yes, they would be pleased
- this is the first month of trading when not many people would know about the restaurant and cash inflows and cash outflows are roughly equal



- they have a positive balance (£980) of cash in their bank account
- Sue and Peter can be confident that they will have enough cash next month — unless things change dramatically

**Business insight**

Textbook p. 74

**Cash flow**

The table shows that in 2007 10% of small businesses thought that cash flow was the biggest obstacle to success. This includes small businesses that have just started up as well as those that have been trading for many years.

<b>Obstacle</b>	<b>Percentage</b>
Competition in the market	15
Regulations	14
Taxation	12
The state of the economy (e.g. whether in recession)	10
Cash flow	10
Recruiting staff	6
Shortage of skills generally	4
Availability/cost of suitable premises	4
Obtaining finance	3

Source: Annual Small Business Survey, Department of Business and Regulatory Reform

**Question**

**Which of the first five obstacles does an entrepreneur have some control over?**

Answers might include:

- The business only has control (to some extent) over its cash flow. No other factors are within its control.

**Caption question**

Textbook p. 75

**Small restaurant**

**Why might this business run short of cash?**

Answers might include:

- it may not persuade enough customers to eat there to provide sufficient inflows of cash
- another restaurant may open up nearby
- the business's rent may suddenly be increased by a large amount
- there may be a health scare about the restaurant meaning that people do not want to eat there



**Quick questions**

**Textbook p. 76**

- 1 What is the difference between a cash inflow and a cash outflow?** (3 marks)
  - A cash inflow brings money into the business (perhaps because the business has received money from a customer) and a cash outflow means that money leaves the business (maybe because of paying a supplier).
- 2 Describe two sources of cash inflow for a small hotel.** (4 marks)
  - guests paying to stay at the hotel
  - people choosing to eat in the hotel's restaurant and paying for their meals
  - customers buying drinks in the hotel's bars
- 3 Describe two sources of cash outflow for a bakery.** (2 marks)
  - paying for flour
  - paying the wages of the bakers
  - paying rent on the bakery premises
- 4 What is the difference between a cash flow statement and a cash flow forecast?** (4 marks)
  - A cash flow forecast is a plan of the expected inflows and outflows to and from a business over a period of time.
  - A cash flow statement is a historical record of the cash inflows and outflows that have taken place over a period of time.
- 5 State two reasons why cash flow statements are important to small businesses.** (2 marks)
  - Cash flow statements help entrepreneurs and managers to understand where and when their cash was spent.
  - This may assist them in making decisions on how to reduce cash outflows if this is necessary.
  - The information in cash flow statements helps managers to decide how to improve cash inflows if necessary.
- 6 State two reasons why cash flow forecasts are important to small businesses.** (2 marks)
  - they can identify times when the business might be short of cash
  - they can take action to avoid cash shortages becoming a major problem
- 7 If a business suffers severe cash flow problems, it may become insolvent. What is insolvency?** (2 marks)
  - Insolvency occurs when a business is not able to meet its financial commitments when they fall due.
- 8 What does a receiver do?** (3 marks)
  - A receiver is a person who takes responsibility for an insolvent business and makes arrangements to pay its debts. He or she has to get as much money as possible from selling the business.
- 9 State two ways in which a business might speed up its cash inflows.** (2 marks)
  - persuading new customers to pay on delivery
  - chasing up customers who owe the business money and persuading them to pay promptly
- 10 Explain two actions a business might take to improve its cash flow position.** (6 marks)
  - find new sources of cash inflows such as selling new products
  - delay cash outflow — persuade suppliers to grant them time to pay
  - reduce cash outflows permanently, for example, find cheaper suppliers
  - the owners could put more money (cash) into the business



Section assessment

Textbook pp. 76–77

### Kimmi's Garage

Kimmi had achieved her dream. Her aunt had left her money in her will and at last she was able to open her own garage repairing and servicing cars. She was confident she would succeed, but after 4 months trading she had experienced some problems, especially with cash flow. Kimmi was a qualified mechanic and had planned her business carefully. However, she was disappointed with the figures in her cash flow statement as they were very different from the figures set out in her forecast. At one point, she had worried about her business becoming insolvent.

	January	February	March	April
<i>Cash inflows</i>				
Kimmi's inheritance	125,500			
Bank loan	5,000			
Sales revenue	500	3,750	3,950	4,250
<b>Total cash inflow</b>	<b>131,000</b>	<b>3,750</b>	<b>3,950</b>	<b>4,250</b>
<i>Cash outflows</i>				
Purchase of buildings	120,000			
Wages	1,500	1,800	1,800	2,000
Interest on bank loan	250	250	250	250
Purchase of tools and materials	10,500	1,200	500	600
Telephone and fuel	350	150	150	160
Marketing	1,000	800	600	400
<b>Total cash outflow</b>	<b>133,600</b>	<b>4,200</b>	<b>3,300</b>	<b>3,410</b>
<b>Net cash flow</b>	<b>(2,600)</b>	<b>(450)</b>	<b>650</b>	<b>840</b>
<b>Opening balance</b>	<b>1,500</b>	<b>(1,100)</b>	<b>(1,550)</b>	<b>(900)</b>
<b>Closing balance</b>	<b>(1,100)</b>	<b>(1,550)</b>	<b>(900)</b>	<b>(60)</b>

## Questions

1 Define the terms 'cash flow' and 'insolvency'.

(4 marks)

- Cash flow is the money that flows into and out of a business on a day-to-day basis.

Award 1 mark for notion of money flows. Award a second mark for fuller understanding such as flows in and out of the business.

- Insolvency occurs when a business is not able to meet its financial commitments when they fall due.

Award 1 mark for the idea of not being able to pay debts and a second mark for simple development such as 'on time'.



**2 Explain why Kimmi might have been disappointed with the figures in her cash flow statement.**

(6 marks)

Level	Descriptor	Mark
2	Candidate explains relevant point(s)	3–6
1	Candidate identifies relevant points	1–2

Answers might include:

- the cash inflows have only risen slowly, by £200–£300 per month
- cash outflows have risen in April by nearly as much as the inflows
- Kimmi's business has a negative cash balance throughout this period
- Kimmi was confident and the figures did not bear this out

**3 Discuss the factors that might have caused the cash flow problems for Kimmi's business.** (10 marks)

Level	Descriptor	Marks
2	Candidate explains relevant point(s)	2–3
1	Candidate states relevant points	1

Answers might include:

- Kimmi spent a large amount of money on the property and tools, leaving her short of cash from the start
- her sales did not increase quickly, perhaps she did not spend enough on marketing and reduced this spending too quickly
- Kimmi had quite a small opening balance at the start
- maybe Kimmi was too confident about her business and did not research it fully
- Kimmi might not have examined her cash flow forecast carefully enough and taken the necessary actions

In addition use the grid below to award marks for evaluation (AO3).

Level	Descriptor	Marks
3	Candidate offers judgement with justification	6–7
2	Candidate offers judgement with some justification	3–5
1	Candidate offers unsupported judgement	1–2

Here candidates may consider the most important reason for Kimmi having cash flow problems or say whether she really had cash flow problems.

### Extension exercise

**Kimmi's business was short of cash during its first 4 months of trading, as shown above. Discuss the actions she might take to improve her business's cash flow in the future.** (10 marks)

Level	Descriptor	Marks
2	Candidate explains relevant point(s)	2–3
1	Candidate states relevant points	1



In addition use the grid below to award marks for evaluation (AO3).

Level	Descriptor	Marks
3	Candidate offers judgement with justification	6–7
2	Candidate offers judgement with some justification	3–5
1	Candidate offers unsupported judgement	1–2

Answers might include:

- she could arrange an overdraft as her cash position is gradually improving
- she might try to delay payments to suppliers for parts and spares as well as fuel
- she might try to increase her cash inflows, for example by repairing lawnmowers or something similar

### Chapter 3 review

Textbook pp. 77–80

#### Item A

Usha Hills started her new business last month. Home Angels offers a cleaning service for busy people in the town where Usha lives. She had to raise £20,000 to set up her business, to buy two vans, cleaning equipment and materials and for marketing. She turned down an offer of an interest-free loan from her mother and borrowed £15,000 from a bank. Usha has one employee and her business has already achieved sales of cleaning 75 homes a month and she expects a further rise in sales. She is confident that her business has made a profit in its first month and has gathered together details of the business's costs and revenues. Usha has managed her business's cash flow carefully and has not needed to use her overdraft.

<i>Monthly costs</i>	
Fixed costs	£750
Variable costs per home cleaned	£20
<i>Revenue</i>	
Selling price	£32
Sales	75 homes

## Question 1

(a) What is meant by the term 'overdraft'?

(2 marks)

- Overdrafts give entrepreneurs and businesses the right to borrow variable amounts of money up to an agreed limit.

Award 1 mark for the notion of a loan and the second mark for the idea of flexibility or other similar evidence of fuller understanding.

(b) What is meant by the term 'cash flow'?

(2 marks)

- Cash flow is the money that flows into and out of a business on a day-to-day basis.

Award 1 mark for stating that it is flows of money and the second mark for the idea of inflows and outflows or other similar evidence of fuller understanding.



**(c) Explain how a 'rise in sales' might affect the profits made by Usha's business.**

(4 marks)

Level	Descriptor	Marks
2	Candidate explains relevant point(s)	3–4
1	Candidate identifies relevant points	1–2

Answers might include:

- A rise in sales might lead to higher revenue improving profits assuming costs rise by a smaller amount.
- However, the rise in sales may have been achieved by cutting prices so the rise in revenue may be less than the increase in costs. In this case profits may have fallen.

**(d) Calculate the following figures for Usha's business for the first month of trading:**

**(i) total costs**

**(ii) revenue**

(6 marks)

Answers are:

- **(i)** total costs = fixed costs + variable costs

$$\text{total costs} = \text{£}750 + (\text{£}20 \times 75) = \text{£}750 + \text{£}1,500 = \text{£}2,250$$

Award 1 mark for identifying elements of variable costs and 1 mark for identifying fixed costs and the third mark for bringing it all together.

- **(ii)** revenue = selling price  $\times$  sales

$$\text{revenue} = \text{£}75 \times 32 = \text{£}2,400$$

Award 1 mark for identifying elements of revenue and 1 mark for identifying total costs and the third mark for bringing it all together.

**(e) Explain how an organisation such as Business Link might have helped Usha to set up and manage her new business.**

(7 marks)

Level	Descriptor	Marks
2	Candidate explains relevant point(s)	4–7
1	Candidate identifies relevant points	1–3

Answers might include:

- it may have offered advice on the best source of finance for the money Usha needed
- Usha has employed staff — it might have offered support in recruiting employees and training
- it could have offered support on paying taxes
- the website could have put Usha in touch with a small business advisor or other entrepreneurs

**(f) Do you think that a bank loan was the best source of finance for Usha's business? Give reasons for your answer.**

(9 marks)

Level	Descriptor	Marks
2	Candidate explains relevant point(s)	2–3
1	Candidate states relevant points	1



Answers might include:

**In favour of the bank loan**

- the bank may have offered advice on Usha’s business as part of the process of granting the loan
- Usha will have had to draw up a business plan (and have it checked by the bank) before having a loan — this will test Usha’s business idea
- Usha should have security that the loan will not be withdrawn

**Against the bank loan**

- this could be an expensive source of finance at a time when the business is not profitable
- Usha could have borrowed money from her mother (presumably cheaply)
- a shareholder or partner could have offered advice or support — as well as finance

In addition use the grid below to award marks for evaluation (AO3).

Level	Descriptor	Marks
3	Candidate offers judgement with justification	5–6
2	Candidate offers judgement with some justification	3–4
1	Candidate offers unsupported judgement	1–2

- it depends on the terms of Usha’s mother’s loan
- what are Usha’s objectives in setting up her business, for example is it to be independent?

**Item B**

Pete Lucas set up his sandwich shop a year ago. The first year of trading has been difficult, although Pete believes that he has earned enough revenue to make a profit over the entire year. He plans to work this out, but is not sure how to do so. Pete has enjoyed running his business but has had some cash flow problems. Without an overdraft, he has often been short of money to pay wages and his suppliers. Some of his business customers have been slow to pay him. Pete is worried because his cash flow problems seem to be getting worse, not better. Last month he had to borrow money from his father to pay his assistant’s wages. His father has told him that he should talk to a business advisor to get some help.

**Question 2**

**(a) What is meant by the term ‘revenue’?**

*(2 marks)*

- Revenue is the income that a firm receives from selling its goods or services.

Award 1 mark for the idea of income and the second mark for the notion of it arising from selling goods or services.

**(b) What is meant by the term ‘cash flow statement’?**

*(3 marks)*

- A cash flow statement is a historical record of the cash inflows and outflows that have taken place over a period of time.

Award 1 mark for the idea of cash flows and the other marks for mentioning inflows and outflows and for it being historical.



**(c) Explain how Pete would calculate his business's profit or loss for the first year of trading.**

(4 marks)

Level	Descriptor	Marks
2	Candidate explains relevant point(s)	3–4
1	Candidate identifies relevant points such as the formula	1–2

Answers might include:

- Profits equal revenue minus total costs.
- Revenue is calculated by multiplying sales by the selling price.
- Total costs are fixed costs plus variable costs.
- Variable costs can be calculated by multiplying the variable cost of one packet of sandwiches by the number of packets that are produced.

**(d) Explain two possible consequences of Pete's business continuing to have cash flow problems.**

(6 marks)

Level	Descriptor	Marks
2	Candidate explains relevant point(s)	3–6
1	Candidate identifies relevant points	1–2

Answers might include:

- he may not be able to pay his suppliers when they demand payment for bread etc.
- he may not have enough money in the business's bank account to pay staff
- he may be unable to accept any business orders unless they pay at the time of ordering
- if the situation gets worse Pete may be forced to close his business

**(e) Explain why Pete might want to talk to a business adviser.**

(6 marks)

Level	Descriptor	Marks
2	Candidate explains relevant points	3–6
1	Candidate identifies relevant points such as the formula	1–2

Answers might include:

- A business advisor may be able to offer ideas on how Pete can improve the performance of his business.
- The adviser may help Pete to improve the management of his cash flow — this is becoming an increasing problem.
- The advisor can help Pete to calculate his profits for the first year of trading — this is important.
- Pete seems inexperienced in managing a business and would benefit from sound advice.

**(f) Discuss how Pete might respond to his cash flow problems. Give reasons for your answer.**

(9 marks)

Level	Descriptor	Marks
2	Candidate explains relevant point(s)	2–3
1	Candidate states relevant points	1



Answers might include:

- he does not have an overdraft and this would be a flexible means of managing cash
- however, overdrafts can be expensive and may be withdrawn
- Pete could ask his suppliers to give him time to pay (trade credit) and this would be a free source of finance
- Pete should chase up his business customers' payments or make them pay when they order, although this might lead to a loss of sales

In addition use the grid below to award marks for evaluation (AO3).

Level	Descriptor	Marks
3	Candidate offers judgement with justification	5–6
2	Candidate offers judgement with some justification	3–4
1	Candidate offers unsupported judgement	1–2

- Pete needs to discover exactly what is causing the problem.
- Not having an overdraft seems a strange decision for a new business — although Pete's bank may not have been willing to grant one.