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# (Unit 3.1)Intro to Finance

**Terminologies:**
Asset
Liability
Equity
Cost vs price
Revenue
Expense
Profit
Dividend

Asset: anything you own and can be
- tangible
- Non tangible

Liability: being legally responsible for something, (or in finance it is something you owe)

Equity: the % of shares of the shareholders (or the owners if it is privately held)

## The balance sheet formula!!! Important

Assestan = liabilities + shareholders equity

Cost vs price:

Cost: an expense given for making a product or service that is
Price: how much a good or service is sold for

Revenue: the total amount of money generated from normal businesses
Sales revenue - sales price x numbers of units sold
Sales Revenue = P x Q

Expenses: cost of operations that a company incurs to generate revenue.

Profits: the amount of money generated after the expenses is payed from the revenue

Dividend: a dividend is a distribution of a companies profits that is given to any select shareholders in the company.

- Finance is the process of acquiring and ma being money for a business
- Accounting is the process of recording money flows and assets for a business

Procurement:
- is known for getting goods and services for the business

**Capital expenditure**
- capital expenditure is known as investments on fixed assets
- Fixed asset is a property opened for 1 year or longer
- It is a long term finance

**Revenue expenditure**
- is spending on a companies general operational costs
- It is funded using short term notice

Examples
- paying bills
- Settling tax bills

- Repayments of debts
- Paying suppliers
- Paying wages
- Paying utilities

# (Unit 3.2) sources of finance

## Internal spruces of finance

- it is money that is raised from the businesses money or original assets
- It involves money that has been previously been earned in the company
- They do not Have to be re paid

### Personal funds:

- owners need to invest their own money into starting a business

- It comes with a risk for the owner: if the business goes bankrupt, money will be lost

owners will receive charges from their investments
- power to make decisions
- right to make future dividends

### Retained profit

- is money a company has left at the end of the trading year after paying all costs, expenses, dividends, and taxes
- Primary source of finance for all business

Adv and dis adv:

- they don't have to be repaid
- It takes many years before money is in place, which means loss in dividends
- Entrepreneurs may be hesitant to use retained profits, since they want the dividends to be paid to themselves

### Sales of an asset

- any asset the person owns, and wants to sell

- They can be both tangible and intangible
- An intellectual property is a non tangible asset

Adv and dis adv
- A business can sell fixed, but this leads to an opportunity cost
- It's often appropriate to use when a business wants to update technology

## Short term sources of finance
- those that are re paid within 12 months.

- are normally used to solve cash flow issues or pay revenue expenditure(opex)
- Some external sources tend to be expensive, so should not finance capital expenditure
- Short term finances include trade credit and overdraft(external sources of finance)

**note: (Outstanding invoice is any type of payment that has to be paid that hasn't been paid already)**

## Medium term finances
- Investments that last 1-5 years

Examples
- most common use of medium term source of finance is a bank loan
- Used to finance capital expenditure to purchase a fixed asset.

## Long term sources of finance
- it is for products that will be used for longer then 5 years

Examples
- all forms of equity are long term sources of finance
- Mortgages are also long term sources of finance. Used to by properties repaid over 25 years

## External sources of finance

### Equity finance
- a type of funding where the provider receives equity of the business

Examples
- business angel

- Venture capital
- Share capital

Adv:
- does not have to be repaid
- Shared risks

Dis adv:
- opportunity cost
- Loss of portion for future dividends

### Business Angel
- a successful, wealthy business person who invests money into new business

- in roi, business angels require part ownership of the business
- Entrepreneurs need to persuade the investor to invest, with a solid business plan

- angels seek high growth and large returns on investment
- Business angle s want it to be set up or grow differently

### Share capital
- it is money that is raised through the issues of shares to new investors on a stock market
- Privately held companies that wish to access large amounts do an IPO
- IPO results in the business becoming public

## Debt finance
### loan capital
- a loan is a medium or long term source of finance, used to buy fixed assets. Mortgages are a longer term source of finance which can be payed 20-30 years, and is used to put jade land or buildings

- collateral must be offered in a loan

- key advantage of a loan is money that is immediately for investments, but is only repaid in small chunks over a period of time

- large companies get loans to reduce taxes

### Overdraft:

- Hugh cost short term loan
- Attached to bank account
- Must be arranged in advance with bank
- Useful to meet day to day expenses, but have the highest interest rates

### Micro finance

- providing financial services to individuals who have very limited income or assets

- microcredit is a subset of micro finance. It refers to small loans that enable businesses to continue operating and managing finances

Disadv

- loan period is relatively short term
- High interest rates

## Other sources of finance

- leasing
- Crowdfunding

### Leasing

- involves renting a fixed asset over a period of time, rather then buying it

Adv

- Can use an asset without having fully fin acne it up
- Can always lease the latest mode, and return it when business no longer needs it

### Crowd funding

- is a form of finance where people, invest small amounts of money to build a business or project
- There are many global platforms to perform crowdfunding

Peer to peer lending
Equity crowdfunding
Reward based crowdfunding
Donation based crowdfunding

**Peer to peer lending**

- when a product is lended

### Equity crowdfunding

- when a vc, or angel funds in return for equity

### Donation based crowdfunding

- Any business that receives donations, with no return

### Reward based crowdfunding

- rewards given, with no return

## Evaluation of sources of finance

- it’s important that business owners and those providing the finance have the same objectives. Financing needs to make sense given the 3 types of business evaluations, which are:

Ownership and size of business
Purpose of business and objectives of the finance
Risk tolerance

### Risk tolerance

- need to consider their own tolerance for risk when choosing finance
- Loans create large risks for business, especially where external environment, or economy is unstable
- best for a business to inky borrow money in a lower risk situation. If risks are higher, and rewards are higher, it is better to go to a business angel or a venture capital

# (Unit 3.3) costs and revenues

## Types of costs

- fixed costs and variable costs
- Direct costs/ indirect costs

## Fixed and variable costs

Does the cost increase directly with production?

- if so then it is a variable cost

## Fixed cost

- a fixed cost are those that stay the same at different levels of output
- They are items that have to be paid for no matter level of output

Examples

- staff wages
- Equipments
- Rent
- Advertising
- Insurance

The graph of a fixed cost looks like this:

The graph of a total cost looks like this:
The total costs = variable cost + fixed cost

The graph of the variable cost:

**The x-axis is labeled as the quantity of the good or service**
**The y-axis is labeled as the cost of the good**

## Direct and indirect costs:

classifying costs relates to the parts business

- Direct costs are directly related to the field you are in
- Indirect costs, are any costs payed outside the field.

## Direct costs

- direct costs include wages, goods they sell, and the electricity to keep the shop lights on

- Involves something directly related to a good or service in a single part of the business

Examples
- staffing costs
- Material costs of product line
- Running costs of a single store

### Indirect costs:
- more difficult to allocate then direct costs.
- They are different in different companies

Examples:
- nationwide advertisement campaigns
- Accountancy
- Salaries of board of directors
- Expenses of running central HR
- ICT and infrastructure costs

## Revenue and revenue streams
- businesses aim to cover costs with revenue generated
- If a business cannot break even, or generate profit, it is called an insolvent
- Revenues are as important as cost of production
- It is important to know the way social enterprises approach revenue and streams different from the commercial enterprises

### Revenue
- is the income that a business earns from selling goods and services

Calculate revenue using:
- revenue - price x quantity

### Revenue streams
- when a business sells one or more product or service
- In case 1 revenue stream crashes, business will have many sources of revenue as back up

## Decision tree
- decision tree is used to determine the risk and reward of the business

It consists of:

- decision notes (a decision must be made)
- probability nodes ( the uncertainty/ probability of success/failure)
- Crossed out lines

## (Unit 3.4) final accounts

### Statement of profit or loss

- also known as income statement. It shows profit or loss generated from its trading activities over 1 year
- the for profit and non profit statements are different from the normal income statement

**For profit organization**

Sales
Cost of sales
Gross profit

- Calculate the gross profit
- Calculate all of the expenses
- From the total profit before interest and tax
- Calculate interest
- Calculate tax based on value after interest
- Calculate the profit before dividends
- Calculate the dividends
- Calculate the retained profit

**Non profit organization**

Similar to the for profit organization, a non profit organization does not generate profit, but it is called a surplus which is re invested into the business

- the non profit organizations do not pay any tax
- They do not give out any dividends

Sales
Cost of sales
Gross profit

- Calculate the gross profit
- Calculate all of the expenses
- From the total profit before interest and tax

- Calculate interest
- Tax = 0
- Calculate the surplus

## Balance sheet!

- is a statement that shows the financial position in the company at a specific point in time

Formula:

- assists = liabilities + shareholders equity

Pie Ltd for the year ending 31 December 2021.

| | Thousands of $ | Thousands of $ |
|---|---|---|
| Non-current assets | | |
| Buildings | 250 | |
| Machinery and equipment | 300 | |
| Motor vehicles | 150 | |
| Accumulated depreciation | (40) | |
| Total Non-current assets | | 660 |
| Current assets | | |
| Cash | 40 | |
| Debtors | 10 | |
| Stock | 20 | |
| Current assets | | 70 |
| Total assets | | 730 |
| Current liabilities | | |
| Overdrafts | 8 | |
| Trade creditors | 7 | |
| Short-term loans | 5 | |
| Current liabilities | | 20 |
| Non-current liabilities | | |
| Borrowing (long term) | 100 | |
| Mortgage | 80 | |
| Non-current liabilities | | 180 |
| Total liabilities | | 200 |
| Net assets | | 530 |
| Equity | | |

| | | |
|---|---|---|
| Share capital | 400 | |
| Retained earnings | 130 | |
| Total equity | | 530 |

### Depreciation:
- over time, the non current assets will lose value or depreciate

**Wear and tear**
- often due to damage over time called wear and tear

**Obsolescence**
- obsolescence occurs when the technology has been more recent innovation

### Calculation depreciation:
- straight line method
- Units of production method

## (Unit 3.5) profitability ratio
EBIT= earnings before interest and tax
EBITDA = earnings before interest, tax, depreciation, and amortization

### Gross profit margin(GPM)
- the gross profit margin is the margin of the gross profit generated before expenses

**Formula:**
Gross profit margin - gross profit/ sales revenue x100

**Strategies to improve gross profit margin:**
- diversification
- Lower prices
- Increase prices

### Profit margin (PM)
- the profit margin ratio is the percentage which profits are made on

**Formula:**

Profit margin = profit before interest and tax/ sales revenue x 100

**Strategies to improve profit margin**

- they use many strategies like raising prices to improve the gross profit margin

They can also reduce expenses. It may be possible for a business to reduce expenses like:

- rent
- Electricity
- Stationery
- Administration

### Return on capital employed

- it is the amount of capital returned from an original amount

**Formula:**
ROCE = profit before interest and tax/ non current liability + equity x 100

Note:

- for profit social enterprises might have a lower ROCE since they are distributing value more widely
- Capital complied can be calculated with fixed assets = current assets + current liabilities

**Strategies to improve ROCE**

- increase sales revenue
- Reduce cost of sales and expenses
- Sell unused and obsolete assets
- Reduce long term liabilities
- Reduce shared capital and retained profit(equity)

Liquidity ratio

## (Unit 3.8) investment appraisals

### Quantitative investment appraisal techniques

payback period
number of years and months it will take for investment to pay itself

## (Unit 3.9) Budgets

- A budget is a plan of how much money you are going to acquire, how much you are going to spend, and how you are going to manage it.

### Cost and profit center

**Profit centers**

- are areas that bring both revenue and costs

**Cost centers**

- are areas which generate cost but no revenue

**Role of profit and cost centres**

Financial roles: gives a clearer picture of relative performance of different parts of business.\

Motivational role: the increase in revenue can increase the budget for departments, and increase motivation

Organisational role: allows for decisions about future strategy and where to invest

### Constructing a Budget

- Can be for any part of a business
- Its purpose is to outline financial resources available
- Planned for a set period of time

Short term budgets: they are usually short term meaning a year or less
Coordinated budgeted: coordinating to certain departments

### Factors to consider

**Internal**

- Changes to Marketting
- Labor turnover
- Operating changes

**External**

- Sociocultural
- Technological
- Economic
- Environmental
- Political changes
- Legal changes
- Ethical changes