3.3 Costs and revenues

Revenues and revenue streams

Businesses should aim to at least cover their costs with the revenue they earn from selling their products. This is called breaking even and you will learn more about how this is calculated in Subtopic 5.5 (/study/app/y12-business-management-a-hl-may-2024/sid-351-cid-174702/book/the-big-picture-id-39338). If a business cannot break even, or earn more revenue than its costs, it may become insolvent. So, for a business, revenues are just as important as costs of production.

Figure 1. Revenue is the most important source of money for businesses.

Credit: Watchara Piriyaputtanapun, Getty Images

However, as with costs, it is important to note that the way social enterprises approach revenue may be different from the way commercial enterprises approach revenue. Revenues may be lower for social enterprises than for equivalent commercial enterprises. This is because social enterprises aim to maximise impact and may offer their goods and services at a lower, affordable price than commercial enterprises. This will make their socially or ecologically beneficial products more widely available to consumers.

Revenue

Revenue is the income that a business earns from selling goods and services. If a for-profit enterprise is going to survive, it needs to generate revenue.

Exam tip

Revenue is the amount of money generated by selling products or earning revenue through other means. Revenue should not be confused with profit. Profit is the amount of money left with the business after all costs have been deducted. Revenue in simple terms means how much money is coming into the business when goods or services are sold.

In a simple one-product business, revenue can be calculated using the following formula:

Total revenue = price x quantity

Using the example of the coffee shop from Section 3.1.1 (/study/app/y12-business-management-a-hl-may-2024/sid-351-cid-174702/book/cap-and-rev-expenditure-id-39227), assume that the business is able to sell its coffee for $4 per cup. The revenue earned at different levels of output is shown in **Table 1** and graphed in **Figure 2**.

Table 1. Revenue earned from different quantities (output) of cups of coffee sold.

Quantity of cups of coffee (output)	Sales revenue in one month ($) ($4 per cup of coffee sold)
0	(0 x 4) = 0
500	(500 x 4) = 2000
1000	(1000 x 4) = 4000
1500	(1500 x 4) = 6000
2000	(2000 x 4) = 8000
2500	(2500 x 4) = 10 000

Quantity of cups of coffee (output)	Sales revenue in one month ($) ($4 per cup of coffee sold)
3000	(3000 x 4) = 12 000

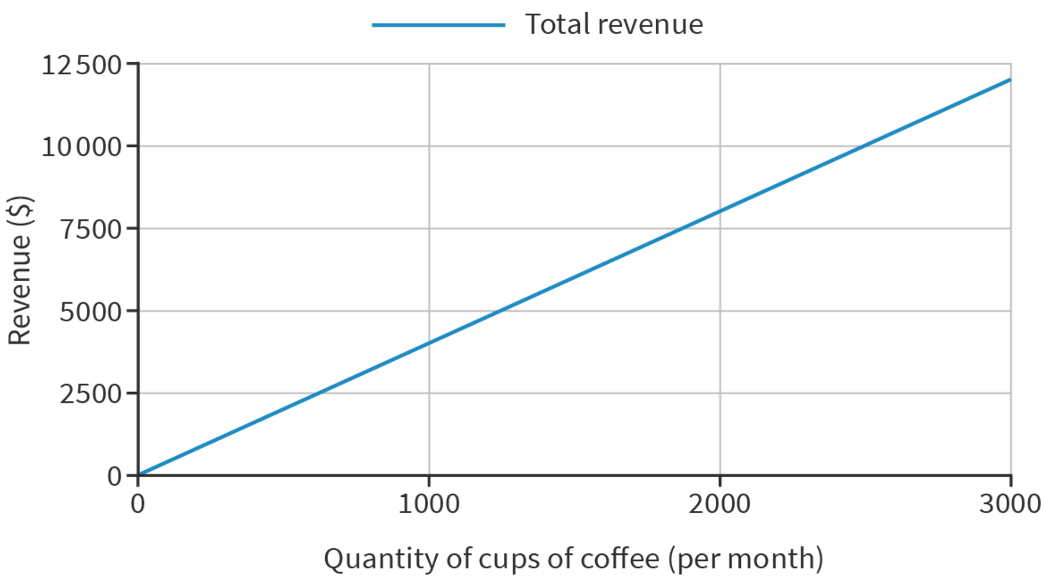

Figure 2. Revenue for a coffee shop with one coffee product.

Figure 3 shows total revenue graphed with the variable costs, fixed costs and total costs. Notice the point where total revenue and total costs intersect. This is known as the break-even point. You will learn more about the importance of this point in Subtopic 5.5 (/study/app/y12-business-management-a-hl-may-2024/sid-351-cid-174702/book/the-big-picture-id-39338).

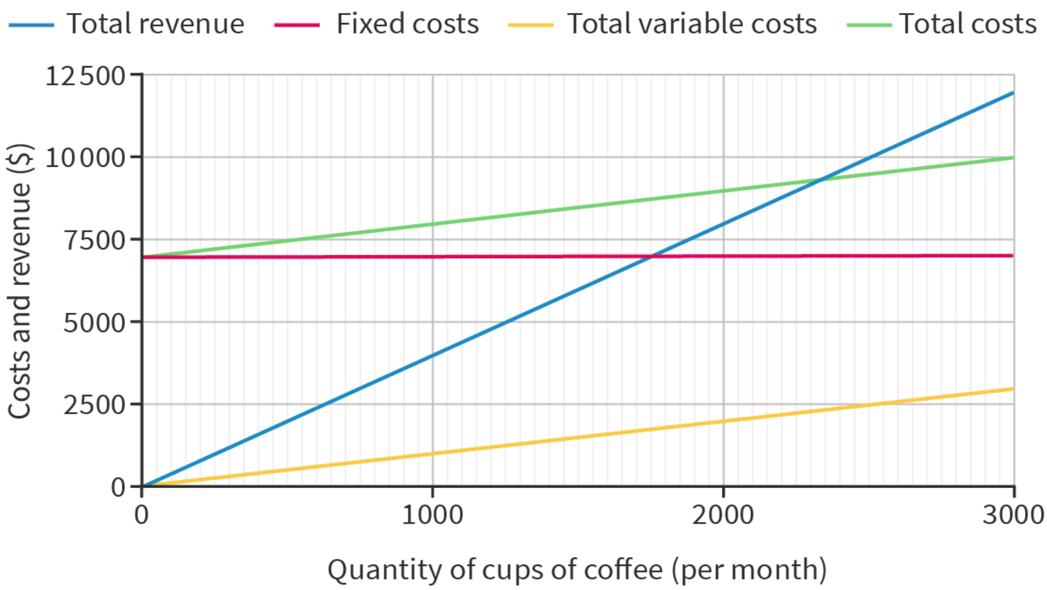

Figure 3. Total revenue, fixed costs, variable costs and total costs for a coffee shop with one coffee product.

Making connections

Variable costs, fixed costs, total costs and revenue will be used in Subtopic 5.5 (/study/app/y12-business-management-a-hl-may-2024/sid-351-cid-174702/book/the-big-picture-id-39338) to calculate the break-even point of a business. The break-even point refers to the quantity of product that a business needs to sell in order to cover total costs with its revenue. You and your teacher may want to cover Subtopic 5.5 straight after this subtopic in order to be able to apply your understanding of costs and revenues to break-even analysis.

Revenue streams

The example used above assumes that the business is selling only one product. However, many businesses will sell more than one product, or perhaps different products and services. These are called different revenue streams.

A revenue stream is one specific way that a company generates income. To take the coffee shop example again, it is likely that the shop sells more than just cups of coffee. It might also offer tea, soft drinks, cakes, sandwiches or other food. Another example is a cinema. Cinemas do not only sell movie tickets. They have other revenue streams such as food and drink, or movie-related products. Larger, more complex businesses may have extra office space that they rent out, or may even earn interest income from loans to other businesses.

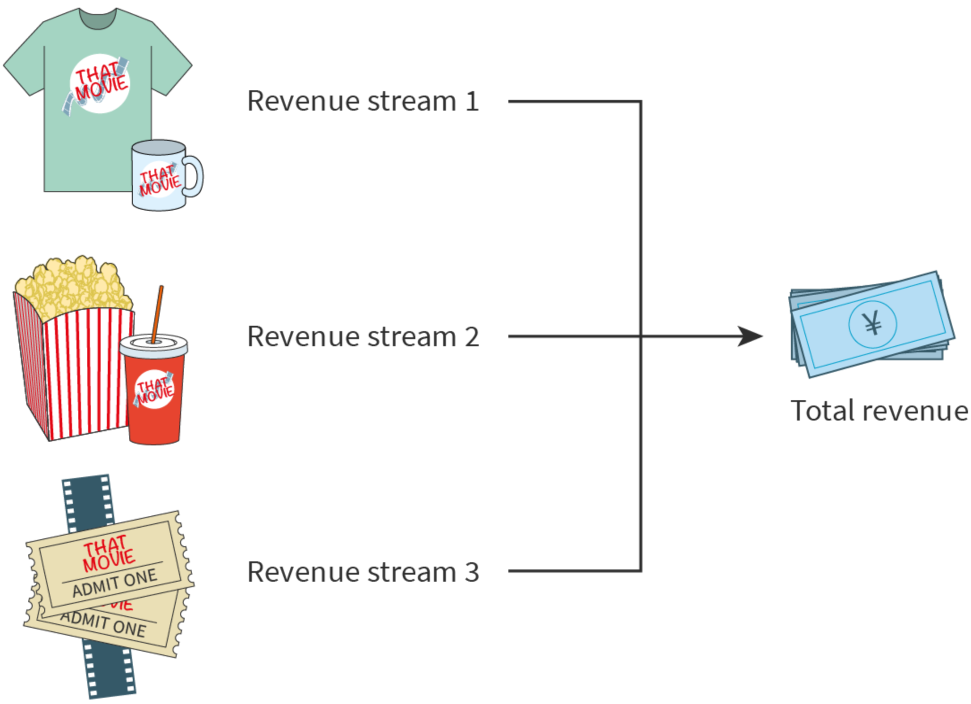

Figure 4. Total revenue and revenue streams for a cinema.

When a business has multiple and diverse revenue streams, it becomes more resilient. Thus, when the revenue from one area declines, for example due to changes in the external environment (such as a pandemic), the business may still be earning revenue from other streams. Like a biodiverse ecosystem, a diverse set of revenue streams will make a business better able to withstand disruptions.

Activity

Go to a local business that you or your family regularly visit. See if you can identify more than one revenue stream for the business, perhaps taking some photographs if appropriate (you may need to ask the business for permission). Share with the class.