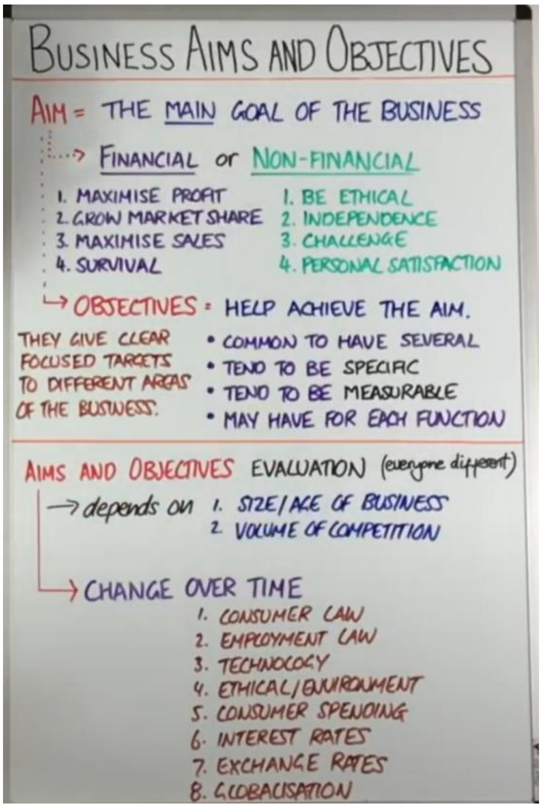
Aims and objectives



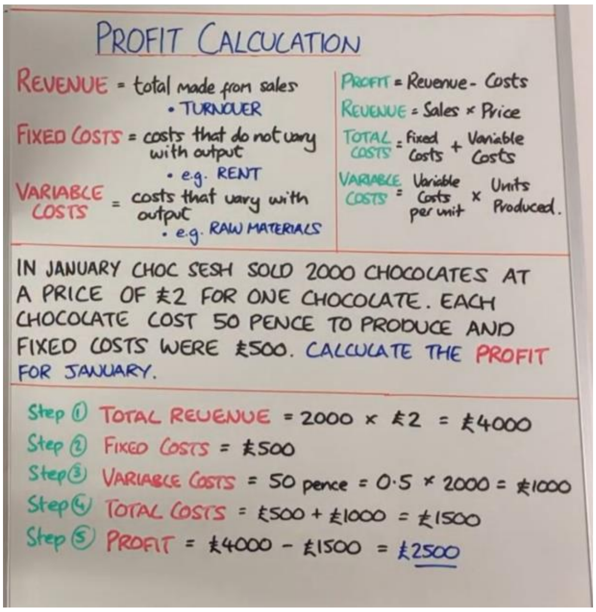
Aim = main goal of business

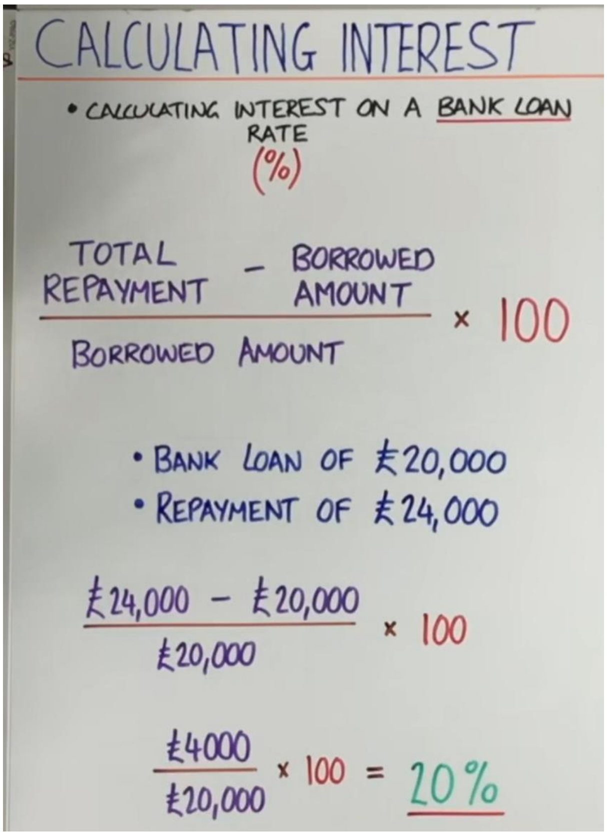
Financial	**Non financial**
Maximise profit	Be ethical
Grow market share	Independence
Maximise sales	Challenge
Survival	Personal satisfaction

Objectives = Help achieve aim

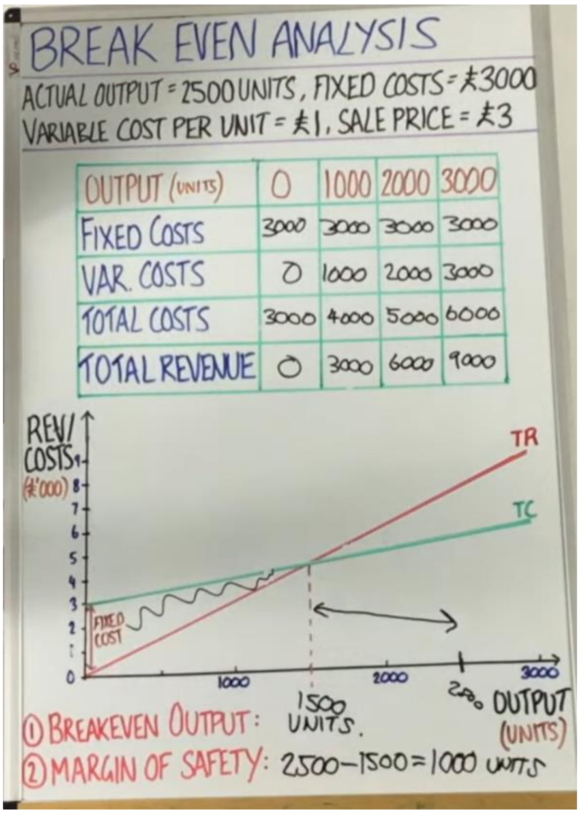
Evaluation

- Depends on
  - Size/age of business
  - Volume of competition
- Change over time
  - Consumer law
  - Technology

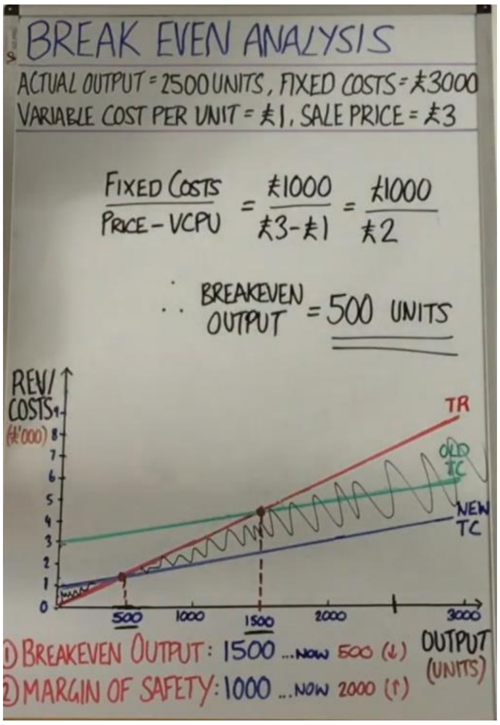




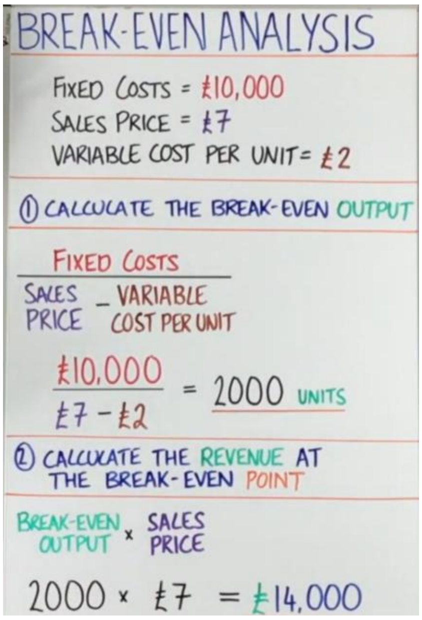
Break even analysis



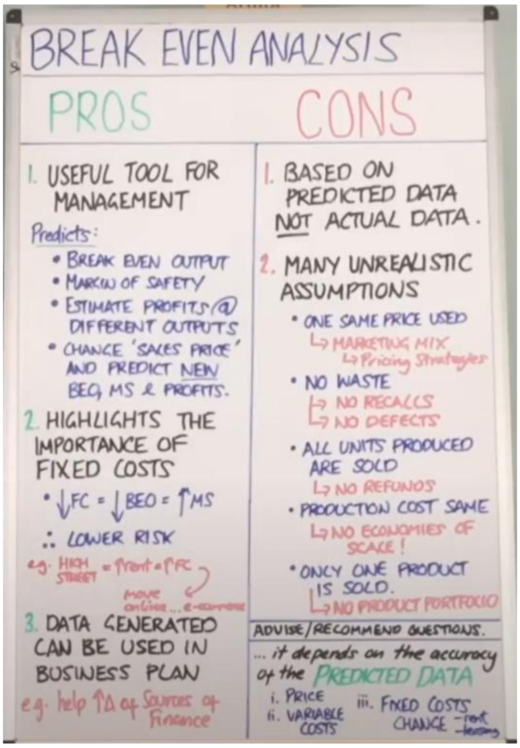
Impact of fixed costs on break even output



Lower fixed costs → lower break even point → Higher margin of safety



Break even analysis



Advantages

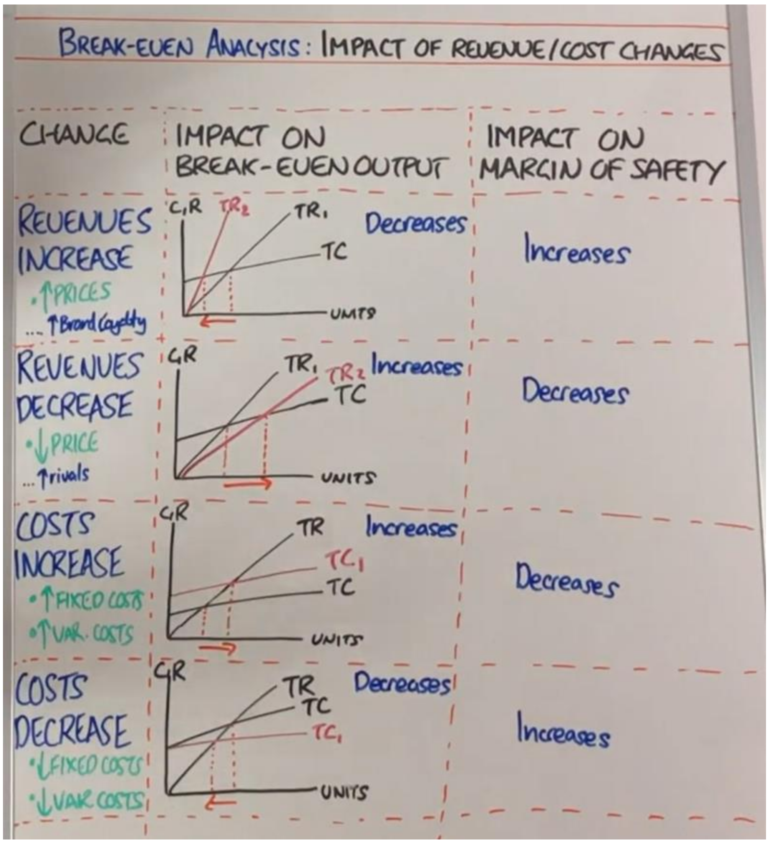
- Useful for management (predicts:)
    - Break even output
    - Margin of safety

- Estimate profits at different outputs
- Change sales price and predict new

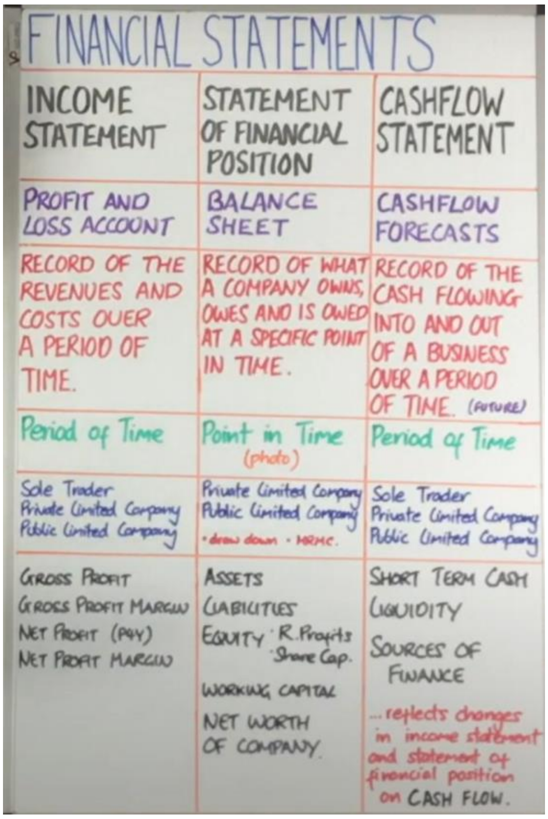
- Highlights importance of fixed costs
    - Lower fixed costs → lower break even output → higher margin of safety
- Data generated can be used in business plan
    - Help increase sources of finance (debt/equity)

Disadvantages

- Based on predicted data not real data
- Many unrealistic assumptions

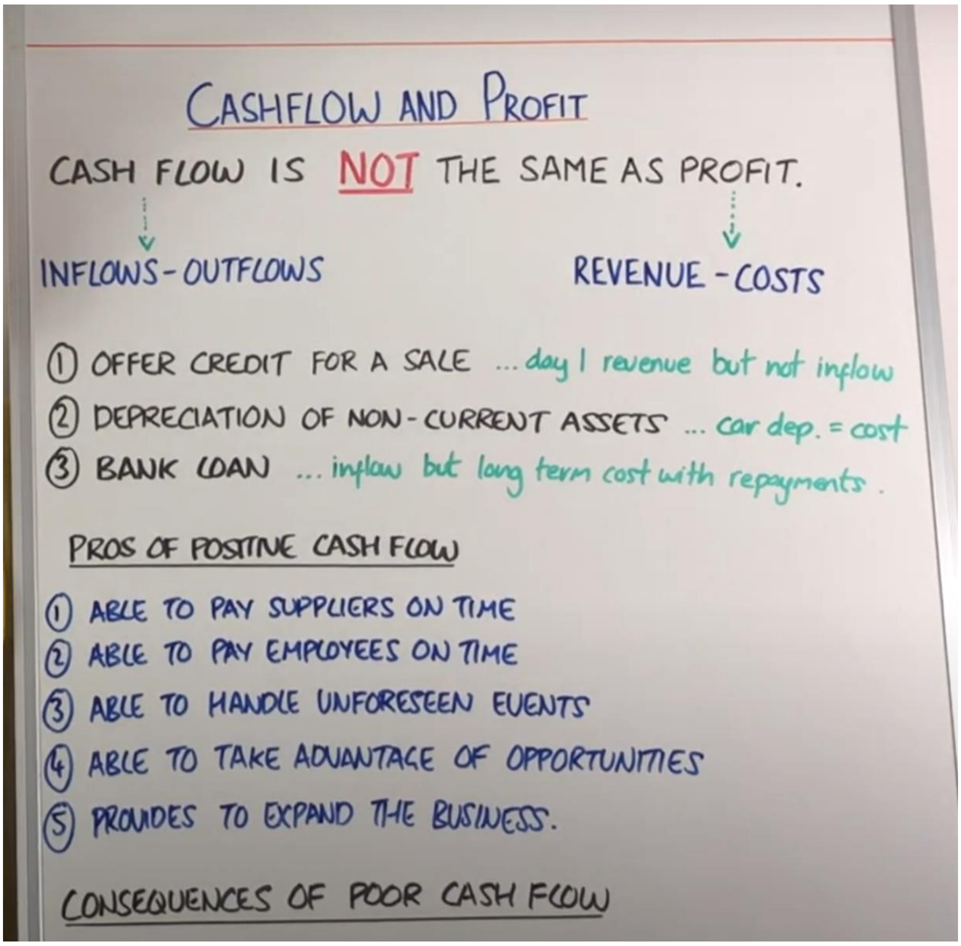


<u>**Financial statements**</u>



Income statements	**Statement of financial position**	**Cashflow statement**
Profit and loss accuracy	Balance sheet	Cashflow forecasts
Record of the revenues and costs over period of time	Record of what a company owns, owes and is owed at a specific time	Record of the cashflow flowing into/out of business over a period of time
Period of time	Point in time	Period of time
Sole trader Ltd PLC	Ltd PLC	Sole trader Ltd PLC
Gross profit margin Gross profit Net profit Net profit margin	Assets Liabilities Equity Working capital Net worth	Short term Liquidity Sources of finance

<u>Difference between cashflow and profit</u>



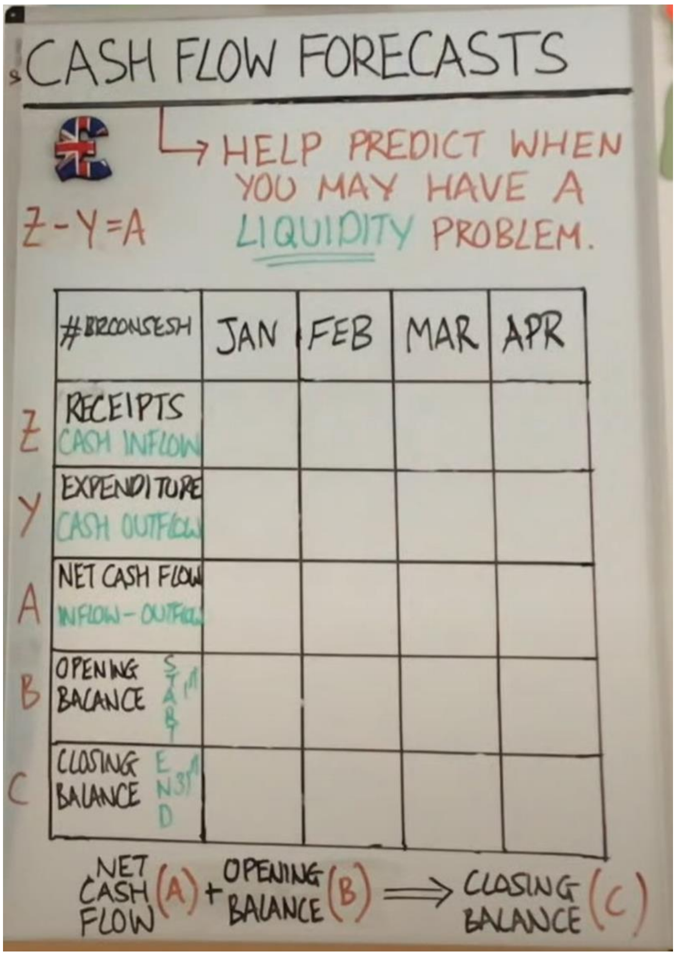
Differences

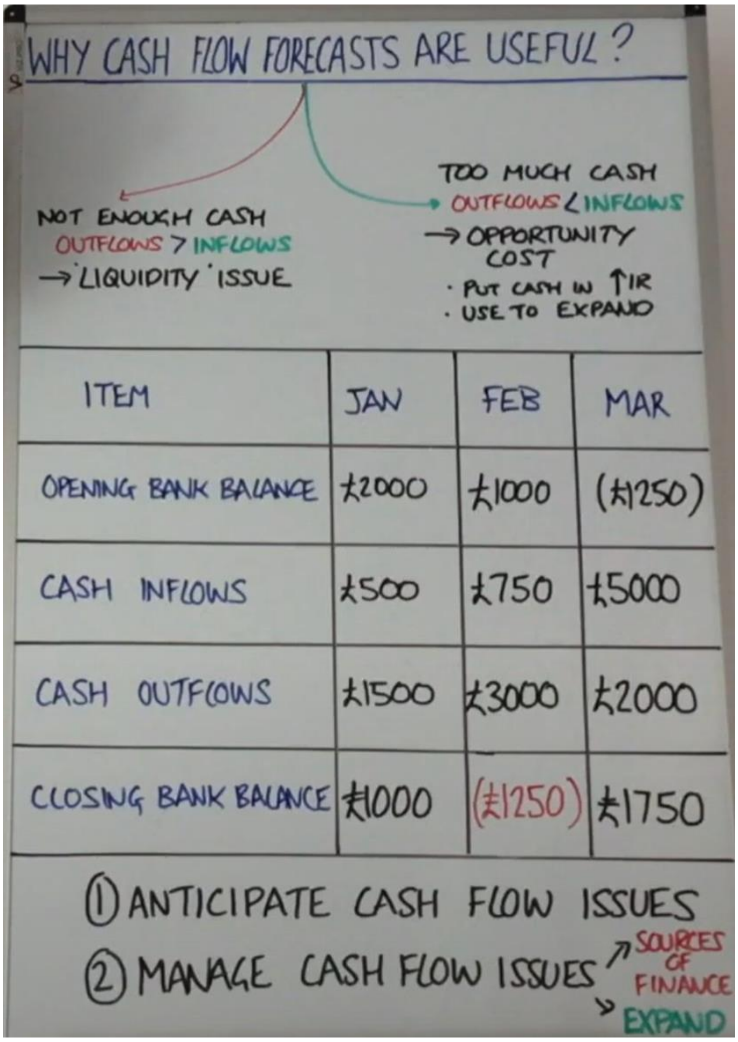
- Offer credit for a sale (earn revenue immediately upon sales but no cash inflow)
- Depreciation of non-current assets
- Bank loan

Advantages of positive cashflow

- Able to pay suppliers on time
- Able to pay employees on time
- Able to handle unforeseen events
- Able to take advantage of opportunities
- Facilitate expansion of business

<u>Cashflow forecasts</u>


CASH FLOW FORECASTS
HELP PREDICT WHEN YOU MAY HAVE A LIQUIDITY PROBLEM.
Z - Y = A
#BRCONSESH
JAN
FEB
MAR
APR
Z
RECEIPTS
CASH INFLOW
Y
EXPENDITURE
CASH OUTFLOW
A
NET CASH FLOW
INFLOW - OUTFLOW
B
OPENING BALANCE
START
C
CLOSING BALANCE
END
NET CASH FLOW (A) + OPENING BALANCE (B) ⟹ CLOSING BALANCE (C)

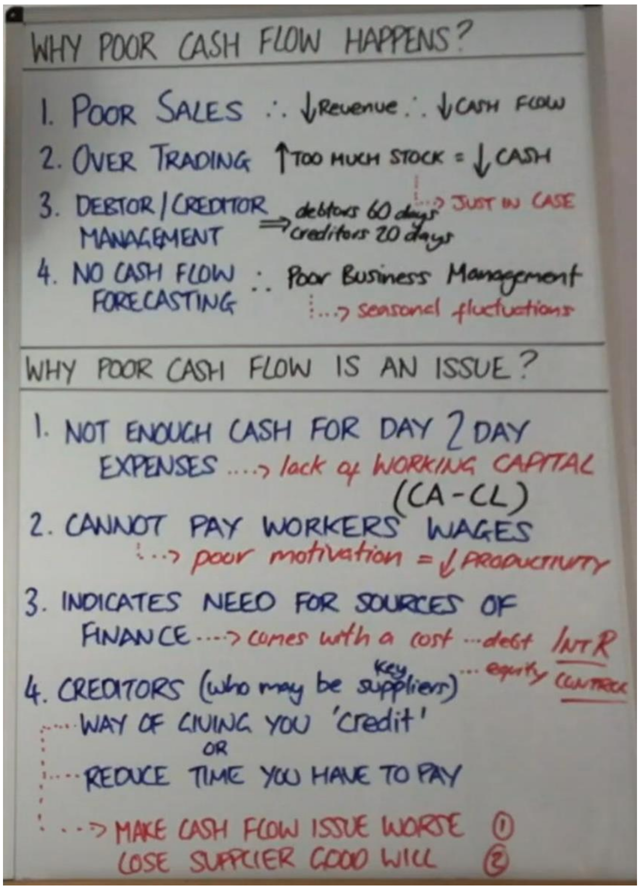


Issues

- Help see when there is not enough cash → liquidity issue
- Help see if you have too much cash → opportunity cost (could be using cash in high interest rate account, expansion)

Why cashflow forecast is useful

- Anticipate cashflow issues
- Manage cashflow issues → use sources of finance (overdraft, expand)



Reasons for cashflow issues

- Poor sales → lower revenue → lower cashflow
- Overtrading → too much stock → less stock
- Poor debtor/creditor → debtor not paying quick enough
- No cashflow forecasting → poor business management (seasonal fluctuations may occur)

Why poor cashflow is an issue

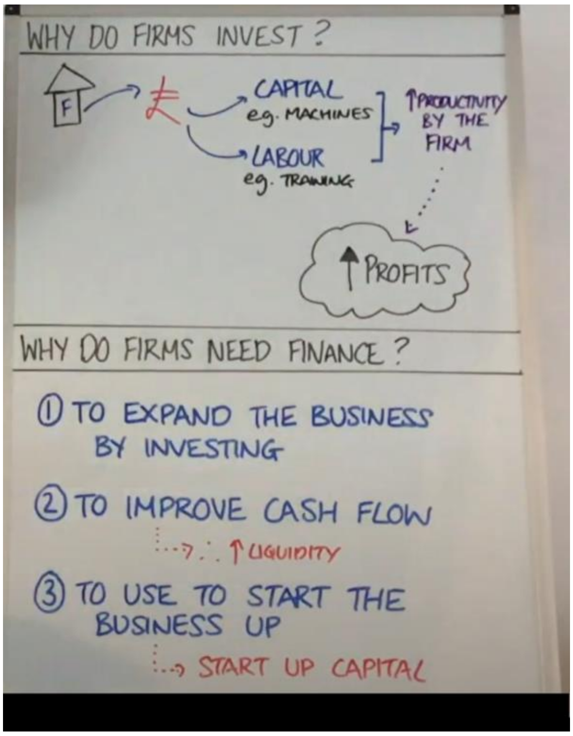
- Not enough cash for day to day expenses (lack of working capital)
- Cannot pay worker and wages → poor motivation → lower productivity
- Indicates need for sources of finance → may go down debt/equity → higher costs
- Creditors (may be supplier)
    - Not want to give credit

    - Reduce time to pay → cashflow issue worsens
    - Lose supplier good will

Solutions to cashflow problems

- Rescheduling payments
    - Increase speed of receiving cash inflow
    - May lose sales due to rescheduling
    - Decrease speed of paying cash outflow → may damage relationships
- Increase cash inflows
    - Run marketing campaign to increase sales → higher costs
    - Increase selling price → lower sales
- Decrease cash outflow
    - Destock (hold less stock) → lower storage costs → lead to lower sales → lower revenue
- Sources of finance
    - Quick and easy to sort → resolve unexpected expenditure
    - Interest/ lower credit score

<u>Investments and finance introduction</u>



Firms will invest

- Capital (machines)
- Get better labour skill force

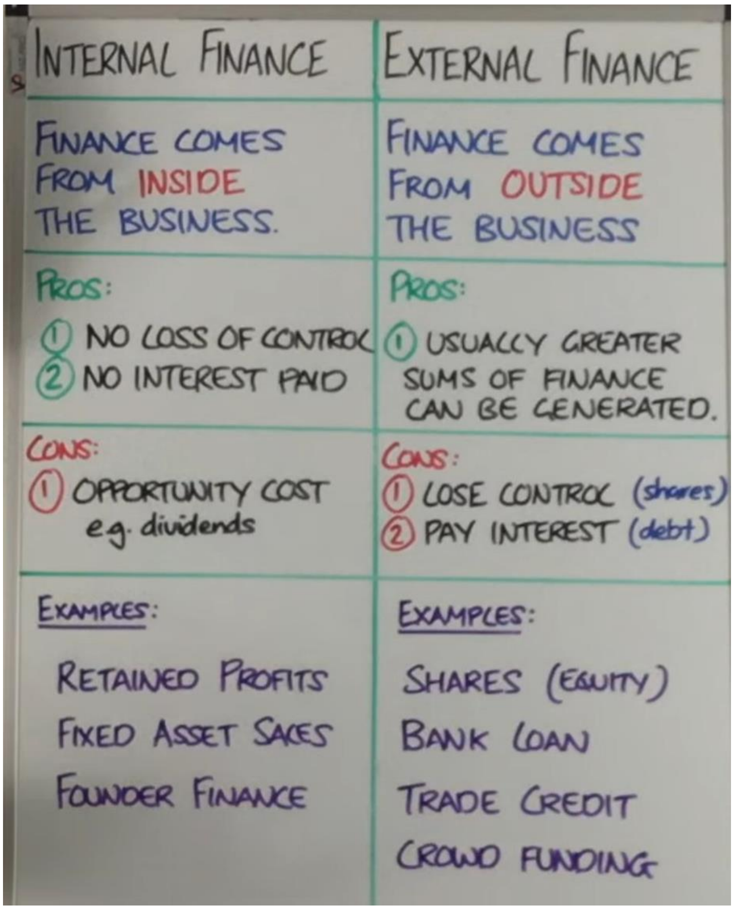
These things will increase productivity of firm → increase profits

Why firms need finance

- Expand business by investing
- Improve cashflow → stop liquidity

Use to start business up (start-up capital)

<u>Internal and external finance</u>



Advantages of internal

- No loss of control
- No interest paid

Disadvantages of internal

- Opportunity cost (dividends)

Examples of internal

- Retained profit
- Fixed asset sales
- Founder finance

Advantages of external

- Greater finance can be generated

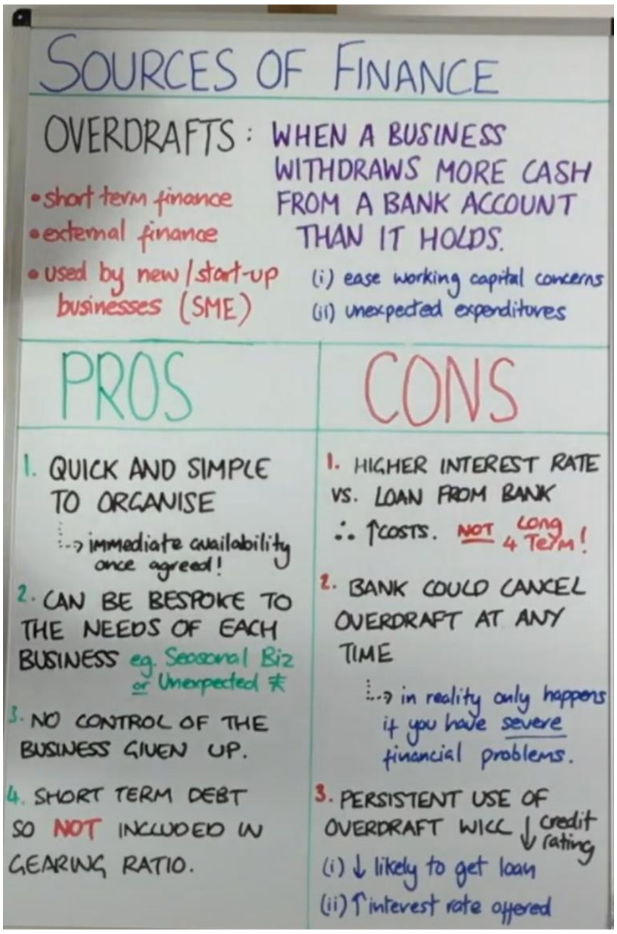
Disadvantages

- Lose control
- Pay interest

Examples

- Shares (equity)
- Bank loan
- Trade credit
- Crowd funding

<u>**Overdrafts**</u>



Overdraft – Business withdraws more cash from bank account than it holds

- Short term
- External
- Used by new businesses
- Why?
    - Ease working capital concerns
    - Unexpected expenditures

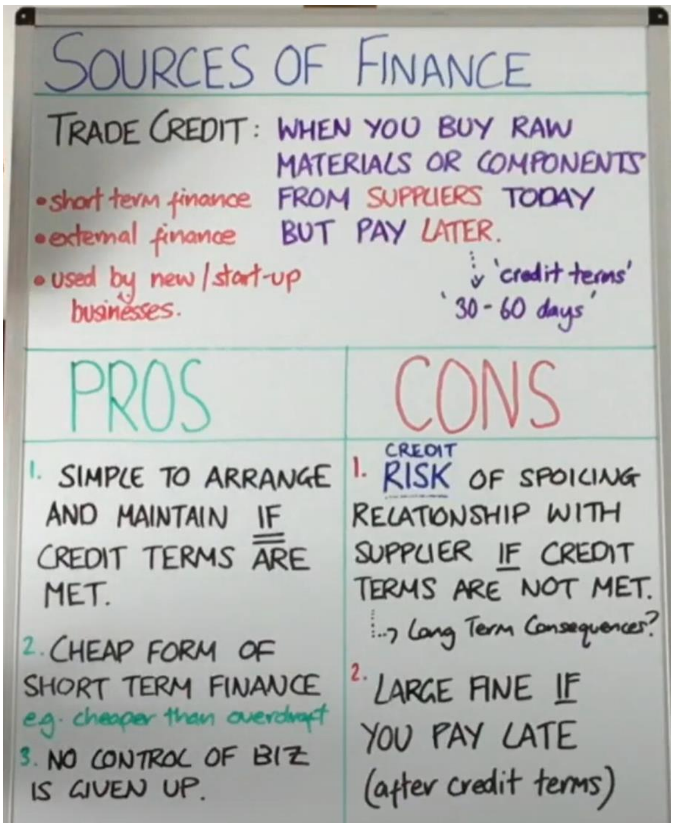
Advantages

- Quick and simple to organise
- Can be bespoke to the needs of each business
- No loss of control
- Short term debt so no gearing ratio

Disadvantages

- Higher interest rate than loan
- Bank could cancel overdraft anytime
- Persistent use of overdraft → lower credit rating → less likely to get loan → higher interest rate offered

<u>Trade credit</u>



Trade credit = Buying raw materials from suppliers but pay later

- Short term finance
- External finance
- Used by new businesses

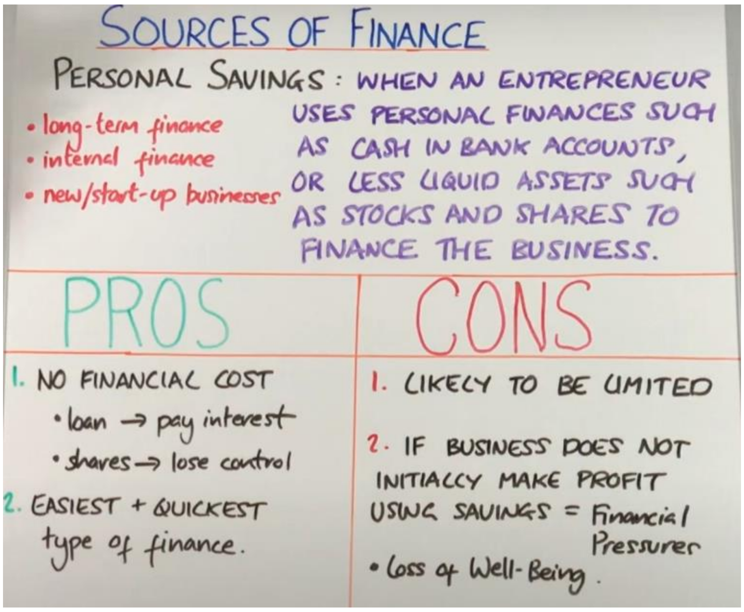
Advantages

- Simple to arrange and maintain if credit terms are met
- Cheap form of short term finance
- No control given up

Disadvantages

- Credit risk of spoiling relationship with suppliers if credit terms are not met
- Large fine if you pay late

<u>Personal savings</u>



Personal savings

- Long term finance
- Internal finance
- New businesses

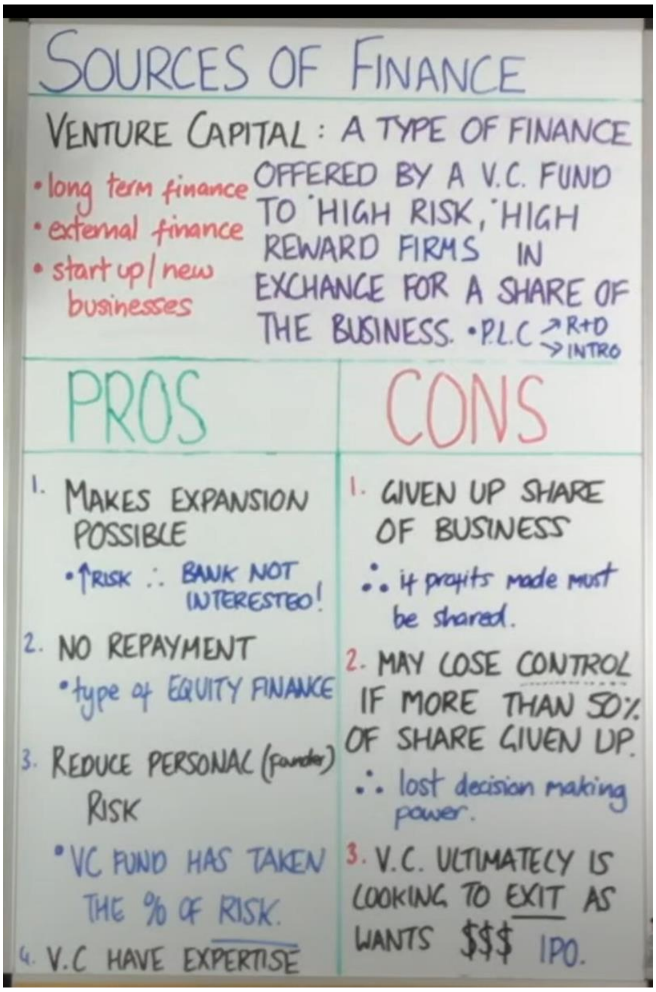
Advantages

- No financial cost
- Easiest and quickest

Disadvantages

- Likely to be limited
- If business doesn't initially make profit (using savings = financial pressure)
- Loss of wellbeing

<u>Venture capital</u>



Venture capital = Offered by venture capitalists to fund a high risk, high reward business in exchange for a share (they see potential)

- Long term finance
- External finance
- New businesses

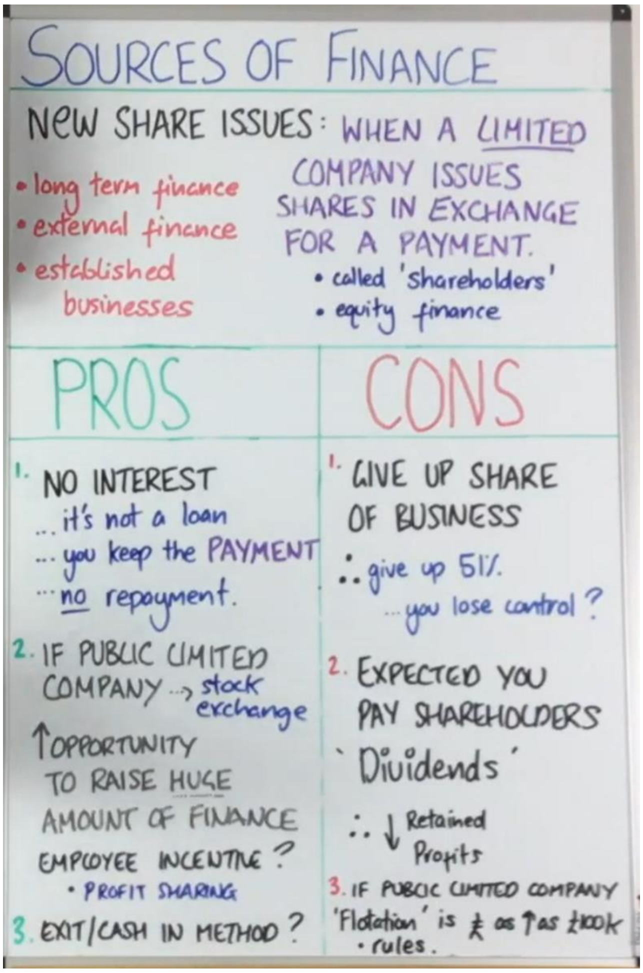
Advantages

- Makes expansion possible
- No repayment
- Reduce personal risk
- Venture capitalists have expertise

Disadvantages

- Loss of control
- Given up share of business → profits must be shared
- Venture capitalists want to sell share for profit

<u>New share issues</u>



- New share issues = Limited company issues shares in exchange for payment

New share issues

- Long term finance
- External finance
- Established businesses

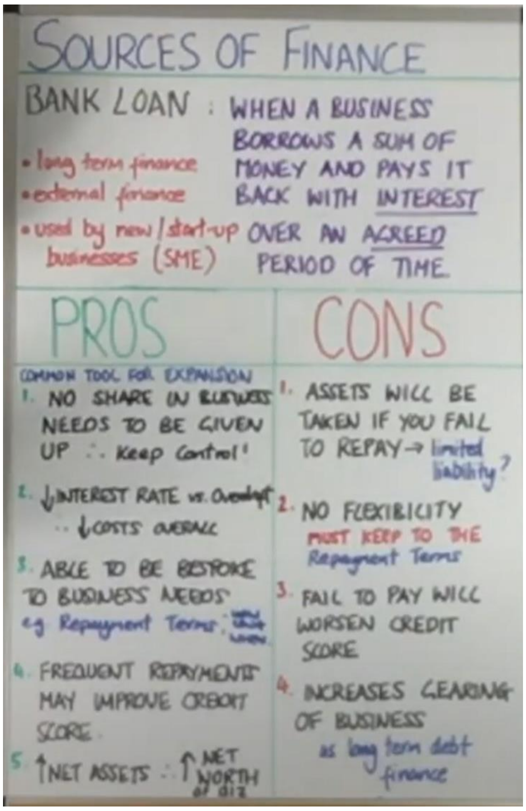
Advantages

- No interest
- If PLC → stock exchange → increase opportunity of huge finance
- Create employee incentive → share profit with employees → increase productivity
- Exit/cash in method

Disadvantages

- Give up shares of business → lose control
- Expected to pay shareholders dividends → lower retained profits
- If PLC → go through flotation → expensive

Bank loan



Bank loan

- Long term finance
- External finance
- Used by new businesses

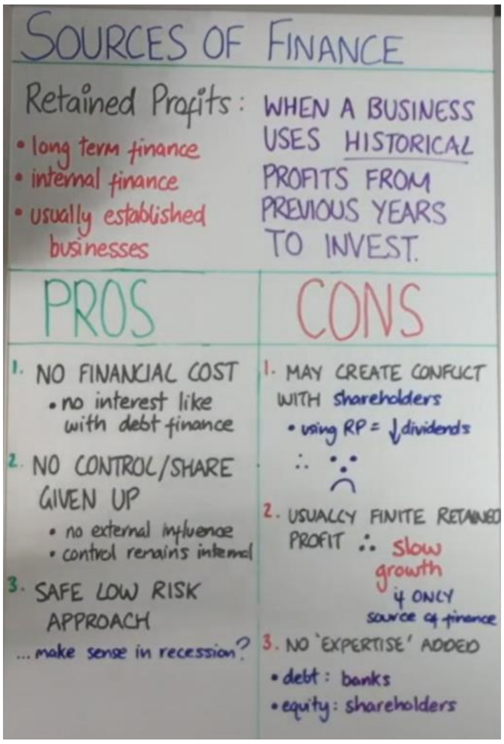
Advantages

- No shares given up → Keep control
- Lower interest rate vs overdraft → lower costs overall
- Able to bespoke to business needs (able to decide when pay)
- Frequent payments → improve credit score
- Increase net assets → increase net worth of assets

Disadvantages

- Assets taken if fail to pay → limited/unlimited?
- No flexibility
- Fail to pay → worsen credit score
- Increase gearing of business

Retained profit



Retained profit = When business uses historical profit from previous years to invest

- Long term finance
- Internal finance
- Used in established businesses

Advantages

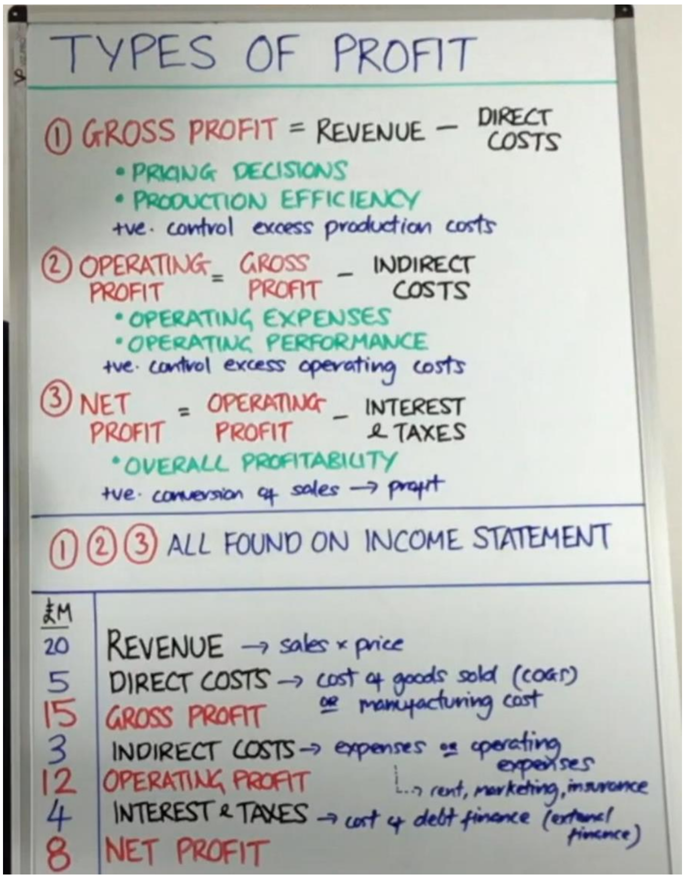
- No financial cost
  - No interest like debt finance
- No control/equity given up
  - No external influence → Control remains internal
- Safe low risk approach (makes sense in recession)

Disadvantages

- May create conflict with shareholders

- Using retained profit → Lower dividends → Become unhappy
- Finite retained profit
  - Slow growth if only retained
- No expertise added
  - Debts → Banks
  - Equity → Shareholders

<u>Types of profit</u>



Gross profit

- Pricing decisions
- Production efficiency
- Control excess production costs

Operating profit

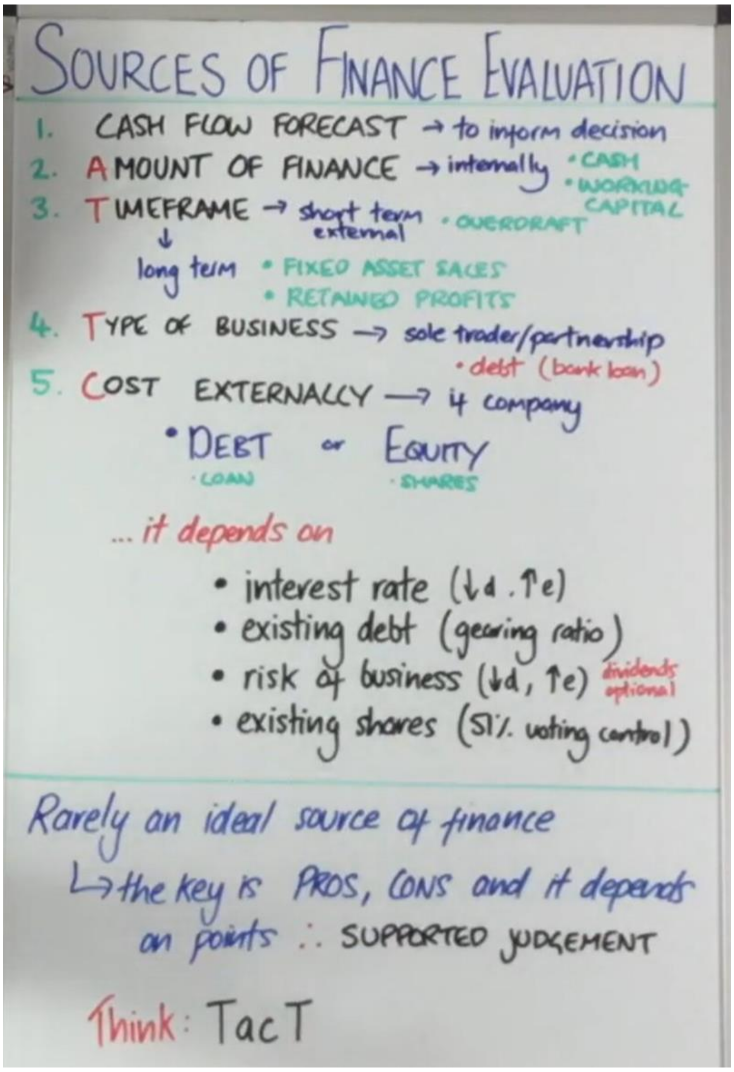
- Operating expenses
- Operating performance
- Can control excess operating costs

Net profit

- Overall profitability
- Shows you conversion of sales → profit

Retained profit

<u>Sources of finance evaluation</u>



Deciding which finance to use (TACT)

- Should do cashflow forecast → make informed decisions
- Amount of finance
- Timeframe
- Type of business → sole trader/partnership
- Cost externally (debt/equity)
    - Depends on
        - Interest rate
        - Existing debt
        - Risk of business
        - Existing shares