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(https://intercom.help/kognity)



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The big picture

Most businesses need money to get started and to continue operations. **Figure 1** shows two partners opening a floristry business. To get started, they will need money to purchase resources such as plants and flowers and perhaps to hire additional staff. They will also likely need to purchase hardware and software to keep account of their supplies, costs and revenues. Even the simplest business is likely to need some funding.



Figure 1. These business partners need money to rent a shop space, buy plants and flowers and purchase technology to keep track of supplies and accounting.

Credit: Kentaroo Tryman, Getty Images

Over time, the floristry business will need money to continue operating. If things are going well, the partners should be able to pay for ongoing expenses like new plants, electricity and wages with the revenues they earn from selling their products. Occasionally, they may need to spend a large amount of money. For example, they could decide to expand their business to another location and set up another shop. At this point, they may need more money than they have available. If this is the case, they might seek additional funding from a bank or another external source.



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Finance is the process of acquiring and managing money for a business. Accounting is the process of recording money flows and assets for a business. This unit will look at both finance and accounting so that you can understand how businesses acquire and manage money, as well as how they record information about the business for themselves and external stakeholders. You will also learn about different forms of business spending.

Learning objective from the IBDP Business Management guide with assessment objective level:

- **Distinguish** between capital expenditure and revenue expenditure (AO2)

3. Finance and accounts / 3.1 Introduction to finance

Capital expenditure and revenue expenditure

Role of finance for businesses Role of finance for businesses

Your school spends money on many things in order to produce and deliver education services. Make a list of all the things in your school that require money. Click on the hotspots in **Figure 1** to help you with this list. What other things might your school spend money on? Can you list some other things that are not shown in the picture?



Figure 1. Click on the hotspots to see some things that schools spend money on.



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The list of things that a school or business spends money on is extensive. It ranges from large expenses such as buildings, to smaller expenses such as paper clips. Purchasing goods and services for a business is known as procurement.

Whatever the expense, the finance and accounting department of the business needs to keep track of it and is responsible for allocating funds to the other three important departments: human resources, marketing and operations. The finance and accounting department must communicate very closely with other departments to make sure that the business stays within budget and meets its financial targets. The finance team is also in charge of planning for the financial future of the business. The finance employees need to pay close attention to the external environment in case important changes occur.

This section explains the two main categories of expenditure for businesses: capital expenditure and revenue expenditure.

Capital expenditure

Capital expenditure, also known as investment, is spending on a company's fixed assets. A fixed asset is an item of property that has value and is owned by a person or business which the business plans on holding or using for longer than one year. Fixed assets are explored later in Subtopic 3.4 (</study/app/business-hl/sid-351-cid-762729/book/the-big-picture-id-39045/>). Examples of fixed assets include purchases of land, buildings and machines. Capital expenditure is the long-term investment in these assets.

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Capital expenditure is often very expensive for a business. These large investments are normally funded using long-term finance. Investment in capital expenditure allows a business to grow in the future. The idea is that extensive research and development will pay off in the long term, even if it involves significant spending in the short term.

Examples of capital expenditure include (see **Figure 2**):

- factories
- delivery trucks or other vehicles needed for the good or service
- technology
- production equipment

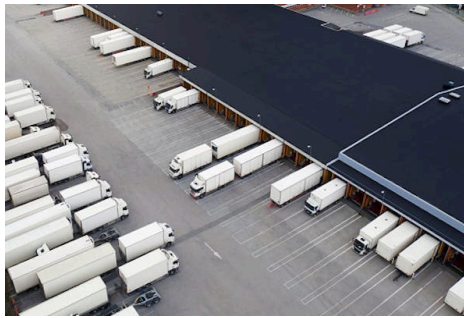
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Credit: thianchai sitthikongsak, Getty Images



Credit: Marcus Lindstrom, Getty Images



Credit: Witthaya Prasongsin, Getty Images



Credit: Westend61, Getty Images

Figure 2. Factories, lorries, technology and production equipment are examples of capital expenses, or investments.



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Revenue expenditure

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Revenue expenditure is spending on a company's general operational costs. It is best thought of as the day-to-day running costs of a company; in other words, the cost a company has to pay on a daily, weekly or monthly basis in order to enable the business to generate revenue.

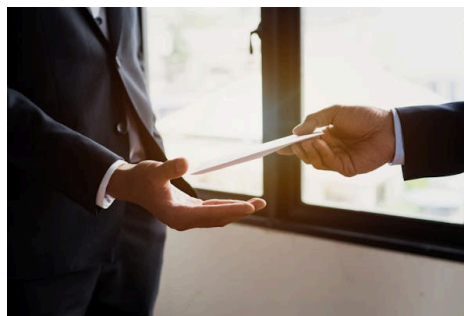
Examples of revenue expenditure include (see **Figure 3**):

- utility bills, such as gas, electricity and water
- paying wages and salaries to workers
- paying suppliers
- settling tax bills with the government
- repayments of debts, such as mortgages and loans

If a business cannot pay for its revenue expenditures, it will go out of business rapidly. This is referred to as insolvency. If they are not paid, employees may refuse to work, suppliers may stop sending materials and utility companies may shut off the electricity or water supply. Revenue expenditure is funded using short-term or medium-term sources of finance.



Credit: Bill Oxford, Getty Images



Credit: Khwanchai Phanthong / EyeEm, Getty Images



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Credit: Alistair Berg, Getty Images



Credit: Casper1774Studio, Getty Images

Figure 3. Utilities, wages, payments to suppliers and taxes are all examples of revenue expenditure.



Concept

Sustainability

The capital and revenue expenditure of companies, known as procurement, has a huge impact on economic, social and environmental sustainability.

Firstly, a business needs to be careful about its spending to ensure that it is economically sustainable in the long term. If spending increases too much, the business may make losses and shut down. This can be devastating for the employees who work in the business, for the suppliers who serve the business, and for the owner(s). If the business is meeting a human need, other stakeholders will suffer too.

Procurement also impacts social and environmental sustainability. The framework that considers corporate social responsibility, which you learned about in [Section 1.3.4](#) ([/study/app/business-hl/sid-351-cid-762729/book/ethical-objectives-and-corp-social-resp-csr-id-36520/](#)), is important here.



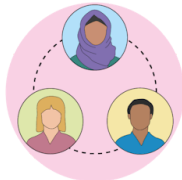

Table 1. A matrix of questions to help a business consider its ecological and social impacts at the local and global scales.



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	Local	Global
Ecological	<p>How can our business support a thriving local natural ecosystem?</p> 	<p>How can our business respect the health of the whole planet?</p> 
Social	<p>How can our business support the wellbeing of local stakeholders?</p>  <p>👁 More information</p>	<p>How can our business respect the wellbeing of people worldwide?</p> 

Businesses should consider the local—social and local—ecological impact of their spending choices. Is the spending of the business contributing positively to local human wellbeing and networks? Is the business spending its money in a way that is regenerating local ecological systems?

Businesses must also consider the global—social and global—ecological impact of their spending. Businesses can choose to direct their procurement to companies elsewhere in the world that are supporting human wellbeing with living wages, safe working conditions and opportunities for personal development. Businesses can also watch out for the health of the whole planet, by procuring goods and services that respect the environment.



Case study

Vestre's new furniture factory in Norway

The Norwegian company Vestre has been making urban furniture for more than 70 years. Its mission to create caring meeting spaces is linked to the networks element of the social foundation in the Doughnut Economics Model you learned about in [Section 1.1.2](#) ([/study/app/business-hl/sid-351-cid-762729/book/the-doughnut-economics-model-id-36500/](#)).



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Figure 4 shows an example of Vestre's 'parklet' furniture. A parklet is a space for social gathering, usually including plants and places to sit, that can be created temporarily or permanently. Parklets are often set up in spaces along the sides of streets, which had previously been used for car parking.

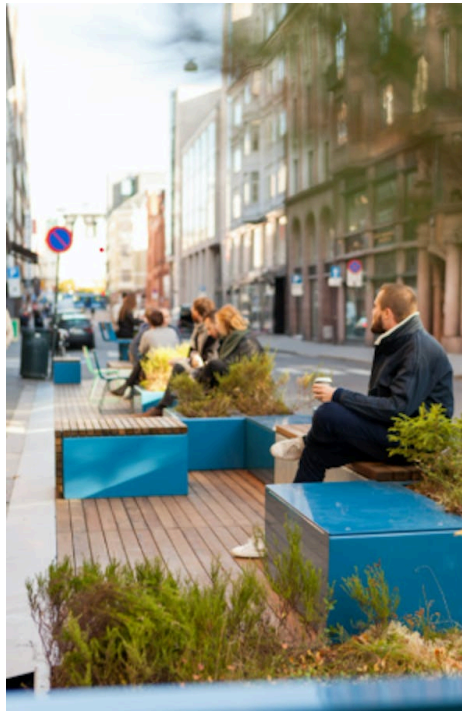


Figure 4. A parklet made by the furniture company Vestre.

Credit: Vestre [\(https://vestre.com/uk/\)](https://vestre.com/uk/)

Vestre is using its revenue expenditures to meet human needs within the boundaries of the planet. For example, the company has been working to change its procurement of resources to reduce its environmental impact. Vestre has joined the Ethical Trading Initiative in Norway and has strict human rights and labour requirements for all of its suppliers. It also offers employment training for people who struggle to enter the labour market.

In 2022, Vestre began building a new factory that claims to be the most sustainable factory in the world. Designed by Danish architecture company BIG (Bjarke Ingels Group), the factory will make use of advanced technologies to reduce its carbon footprint, water use and impact on the surrounding forest. The 300 million NOK capital expenditure [\(http://www.forbes.com/sites/roddyclarke/2020/07/27/could-this-be-the-worlds-most-eco-friendly-furniture-factory/?sh=66895409732e\)](http://www.forbes.com/sites/roddyclarke/2020/07/27/could-this-be-the-worlds-most-eco-friendly-furniture-factory/?sh=66895409732e) aims to show the world how manufacturing can move to a sustainable future. In the video, Jan Christian Vestre explains the sustainability of the factory and other actions the company is taking to direct spending in positive ways.



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THE PLUS // Jan Christian Vestre about the world's most e...



Video 1. Jan Christian Vestre talks about Vestre's environmentally friendly furniture factory.

Questions

1. Define 'mission statement'. [2 marks]
2. Distinguish between revenue expenditure and capital expenditure.
[4 marks]
3. Explain **two** ways that Vestre is meeting objectives related to corporate social responsibility (CSR). [4 marks]

Hint: You may wish to consider either of the following (see [Section 1.3.4](#) (/study/app/business-hl/sid-351-cid-762729/book/ethical-objectives-and-corp-social-resp-csr-id-36520/)):

- local—global and social—ecological responsibilities (related to the Doughnut Economics Model)
- the Sustainable Development Goals (SDGs)

Question 1

A mission statement states what the organisation does, right now, in order to achieve its vision. It is action-oriented and provides guidance on the purpose of the business.

Define is an AO1 level command term, requiring the precise meaning of a term.

- One mark is given for a vague definition.
- Two marks are given for a complete definition.
- Definitions do not require application to the stimulus material.

Question 2

Revenue expenditure refers to spending on a company's general operational costs; this spending will enable the business to generate ongoing revenue. In the case study, the purchasing of the steel for Vestre's urban furniture would be considered revenue expenditure.

Capital expenditure refers to spending on fixed assets. In the case study, the 300 million NOK spent on Vestre's new factory is an example of capital expenditure.



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The difference between revenue expenditure and capital expenditure is related to what the money is spent on. Revenue expenditure is spending on day-to-day operations; capital expenditure is spending on fixed assets. (You could also highlight the difference in financing: short-term, medium-term and long-term (see [section 3.2.1](#) ([/study/app/business-hl/sid-351-cid-762729/book/internal-sources-of-finance-id-39255/](#))), or another difference.)

Distinguish between is an AO2 level command term, requiring that you make clear the differences between two or more concepts or items.

- Two marks each are given for an appropriate explanation of revenue expenditure and an appropriate explanation of capital expenditure, with reference to the case study. To access full marks, the difference between the two terms needs to be clear, perhaps through a sentence that makes the difference explicit.
- To achieve full marks, you must always include theory and application to the case study in your responses to the **explain** command term.

Question 3

Sample responses (other content is also possible):

One way that businesses can meet CSR objectives is by improving their impact on the environment by reducing their CO₂ emissions from energy use during production. This will reduce impact on climate change, one of the planetary boundaries of the Doughnut Economics Model. Vestre is reducing CO₂ emissions by powering its factory with solar panels and moving to carbon neutral steel use.

Another way that businesses can meet CSR objectives is by improving their impact on society. This could be done at the local level by supporting social initiatives or networks in their communities. Or it could be done at the global level by working with suppliers who are supporting human wellbeing. Vestre is doing both. The company provides training for local people who have been unable to access the labour market and it 'has strict human rights and labour requirements for all of its suppliers'.

Explain is an AO2 level command term, requiring a detailed account including reasons or causes. Explain *why*, explain *how*.

- Two ways of meeting CSR objectives need to be explained. Other responses are possible and would be rewarded if appropriate.
- To achieve full marks, you must always include theory and application to the case study in your responses to the **explain** command term to access full marks.



Activity

Learner profile: Thinkers

Approaches to learning: Thinking skills (critical thinking)



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The statements in **Figure 5** give examples of spending by different businesses. Classify each statement as either revenue expenditure or capital expenditure by dragging it into the correct column.



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Potlaç Kafe pays its employees their wages.

Tesla spends five billion euros to build a new car manufacturing factory near Berlin, Germany.

The Erhi Music Shop spends money on flyers to distribute to the local community about new music lessons.

Alamini purchases new sewing machines for his tailoring business.

The Beijing Institute of Technology purchases 3D printers.

Everlane buys recycled nylon fabric for its swimsuits.

Zopilote Surf Camp spends money to build new cabins for guests.

✓ Check

Interactive 1. Classify: Revenue Versus Capital Expenditure.

3. Finance and accounts / 3.1 Introduction to finance

Checklist

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What you should know

By the end of this subtopic, you should be able to:

- define the following terms: (AO1)
 - capital expenditure
 - investment
 - revenue expenditure
- distinguish between capital expenditure and revenue expenditure (AO2)



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3. Finance and accounts / 3.1 Introduction to finance

Reflection

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Teacher instructions

The goal of this section is to encourage students to pause at the end of the subtopic and to reflect on their learning. Students can use the questions provided below to guide their reflection. The questions encourage students to look at the bigger picture and to consider how the subtopic's contents might have impacted the way they view the subject.

The following table shows you how each prompt aligns to the DP *Business management guide*:

Prompt #	Syllabus alignment
1	Concept: Sustainability
2	Tool: STEEPLE analysis

Students can submit their reflections to you by clicking on 'Submit'. You will then see their answers in the 'Insights' part of the Kognity platform.



Reflection

In this subtopic you learned about the role of finance in business management and looked at types of expenditures.

Take a moment to reflect on your learning so far. You can use the following questions to guide your reflection. If you click 'Submit', your answers will be shared with your teacher.

1. Do you know of businesses that do not have any or have minimal capital expenditure? How can such businesses be economically sustainable?
2. Choose two STEEPLE factors (see [Section 1.1.5 \(/study/app/business-hl/sid-351-cid-762729/book/tool-swootsteeples-analysis-id-36504/\)](/study/app/business-hl/sid-351-cid-762729/book/tool-swootsteeples-analysis-id-36504/)). How can they potentially affect capital and revenue expenditures?



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⚠ Once you submit your response, you won't be able to edit it.

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Submit

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Help us improve the content and user experience.



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