

Unit 2: Finance for Business

Level: **1 and 2**

Unit type: **Core**

Guided learning hours: **30**

Assessment type: **External**

Unit introduction

All businesses have to spend money before they can make a profit, and when they spend money, they incur costs. In this unit, you will explore the types of costs that businesses incur, from the initial start-up costs involved in setting up a business to the ongoing daily costs of running the business. You will then explore the ways in which the sale of products and services generates revenue, so that you can develop your understanding of profit.

Next, you will examine how businesses plan for success and learn about the techniques used to assist the planning process. In particular, you will learn how to calculate the break-even point – the point at which sales equal costs (fixed and variable). All sales over the break-even point produce profits, while any drop in sales below that point will produce losses. You will be introduced to the benefits of break-even analysis to ensure that a business knows how and when to prevent losses.

As well as profit, cash is an important factor in business success. It is vital for any business to ensure that it budgets correctly and that it knows what money is coming in to the business and what needs to be paid out, and when. In this unit, you will learn how to use budgets and cash flow forecasts to deal with these important issues.

The final part of the unit explores the ways in which businesses measure success and identify areas for improvement. You will understand how gross profit and net profit are calculated and you will learn about the relationship between sales, cost of sales and gross profit. You will analyse key financial statements (e.g. profit and loss accounts, balance sheets) and review their importance in the successful financial management of a business.

Learning aims

In this unit you will:

- A understand the costs involved in business and how businesses make a profit
- B understand how businesses plan for success
- C understand how businesses measure success and identify areas for improvement.

Learning aims and unit content

What needs to be learnt

Learning aim A: Understand the costs involved in business and how businesses make a profit

Topic A.1 Understand the costs involved in business

Learners should:

- understand and identify costs of a business, including:
 - start-up costs – the costs incurred when setting up a business
 - operating (running) costs – the costs incurred in the day-to-day running of a business
- understand, define and identify the differences between fixed and variable costs, direct and indirect costs, total costs
- calculate total costs (formula will not be given in the assessment)

$$\text{total costs} = \text{fixed costs} + \text{variable costs}$$

Topic A.2 Understand how businesses make a profit

Learners should:

- understand and identify how businesses make money (generate revenue) – from selling their products or services
- identify sources of revenue for a business
- calculate revenue (formula will not be given in the assessment)

$$\text{revenue} = \text{number of sales} \times \text{price per unit}$$

- describe how businesses have to spend money (expenditure) in order to succeed
- identify types of expenditure (including overheads) businesses may have
- understand that expenditure is anything a business pays out and overheads are the everyday running costs of a business
- understand that businesses must know how much money is coming in (revenue) and going out (expenditure), before they can work out whether the business has:
 - made a profit
 - made a loss
- define:
 - profit – revenue is more than expenditure
 - loss – expenditure is more than revenue
- calculate profit (formula will not be given in the assessment)

$$\text{profit} = \text{revenue} - \text{expenditure}$$

What needs to be learnt**Learning aim B: Understand how businesses plan for success****Topic B.1 Understand the planning tools businesses use to predict when they will start making a profit**

Learners should:

- define breakeven – when a business has made enough money through product sales to cover the cost of making the product (no profit and no loss)
- be able to interpret from a break-even chart:
 - break-even point
 - profit
 - loss
 - variable costs
 - fixed costs
 - total revenue
 - total costs
 - margin of safety
- calculate the breakeven (formula will be given in the assessment)

$$\text{Breakeven} = \frac{\text{fixed costs}}{\text{selling price per unit} - \text{variable cost per unit}}$$

- analyse and explain the value and importance of breakeven analysis to businesses when planning for success
- analyse and explain the associated risks to businesses of not completing a breakeven analysis
- present given information graphically on a break-even chart
- analyse the effect on the break-even point if sales or (fixed and variable) costs change, and explain the impact of these changes on the business

Topic B.2 Understand the tools businesses use to plan for success

Budgeting – learners should understand:

- the purpose of budgeting in setting expenditure and revenue budgets
- the difference between budgeting and budgetary control (checking performance against plan)

Cash flow forecasting – learners should:

- know the purpose of a cash flow forecast – to identify the money that should be coming into a business (inflows) and the money going out of the business (outflows) over a period of time
- be able to identify inflows and outflows
- explain the purpose of a cash flow forecast, including that it identifies the flow of cash through a business over a period of time
- understand the sources of cash coming into the business (inflows)
- understand the sources and destination of cash leaving the business (outflows)
- identify the impact of timings of inflows and outflows

continued

What needs to be learnt

- understand the benefits of using a cash flow forecast to plan for success in a business (e.g. to produce new goods/services, invest in new resources, expand/reduce activities) and explain the associated risks to businesses of not completing a cash flow forecast
- complete a cash flow forecast from given information, showing individual and total inflows, individual and total outflows, net inflows and outflows, and opening and closing balances
- analyse a business' finances based on cash flow information and identify possible issues for the business from any cash surplus or deficit

Learning aim C: Understand how businesses measure success and identify areas for improvement**Topic C.1 Understand how businesses measure success**

Making a profit – learners should:

- define cost of sales – the cost of producing a product
- define gross profit – the money made from selling a product (revenue) after the cost of producing the product (cost of sales) has been deducted
- calculate gross profit (formula will not be given in the assessment)

$$\text{gross profit} = \text{revenue} - \text{cost of sales}$$

- explain the impact of positive and negative gross profit on businesses
- define net profit – the money made from selling a product after all costs (expenditure) have been deducted (formula will not be given in the assessment)
- calculate net profit

$$\text{net profit} = \text{gross profit} - \text{expenditure}$$

- explain the impact of positive and negative net profit on businesses

Measuring success by looking at financial statements – learners should:

- understand what financial statements are – documents that record the financial activities of a business, sometimes required by law, including income statement (profit and loss account) and statement of financial position (balance sheet)

Income statement (profit and loss account) – learners should:

- identify the purpose of a income statement (profit and loss account) – to show how the business performed financially over a period of time (usually one year)
- complete an income statement (profit and loss account) from given figures, including:
 - trading account (top section of the income statement) – includes figures for revenue (turnover) and cost of sales and calculates the amount of gross profit
 - expenses/overheads (bottom section of the income statement)
 - calculating net profit

continued

What needs to be learnt

Statement of financial position (balance sheet) – learners should:

- identify the purpose of a statement of financial position (balance sheet) – to show the financial position of a business at a point in time
- understand the format of a statement of financial position (balance sheet)
- categorise total assets and liabilities using a statement of financial position (balance sheet)
- understand that a statement of financial position (balance sheet) shows at a point in time:
 - how a business is funded (capital)
 - how a business is using these funds (net assets)
- complete a statement of financial position (balance sheet) with given figures for a small business (such as a sole trader or partnership), identifying:
 - net assets – what the business owns, or is owed (debtors/trade receivables), including fixed assets and short-term assets
 - liabilities – what the business owes to others (creditors/trade payables), including current liabilities and long-term liabilities
 - capital – how the business is funded (money invested in the business to generate revenue) from:
 - internal sources – money from shareholders (share capital) or retained profits
 - external sources – bank loans or other forms of finance that have to be repaid
 - working capital – the amount of capital used to run day-to-day activities (current assets minus current liabilities): if this figure is negative, the business may have problems financing its day-to-day activities

Topic C.2 Understand how businesses can be more successful

Learners should:

- identify ways in which a business can increase profits
- analyse financial statements for a small business (such as a sole trader or partnership) and suggest appropriate actions the business can take to succeed

Teacher guidance

Resources

There are no special resources needed for this unit.

Assessment guidance

It is advisable for centres to teach the content of this unit towards the beginning of the course as the content of other units builds on the content of this one.

This unit is externally assessed using an onscreen test. Pearson sets and marks the test. The test lasts for one hour and is worth 50 marks. The assessment is available on demand.

Learners will complete an onscreen test that has different types of questions including objective and short-answer questions. Where appropriate, questions contain graphics, photos, animations or videos. An onscreen calculator is available for questions requiring calculations. An onscreen notepad is available for making notes. Each item will have an accessibility panel that allows a learner to zoom in and out, and apply a colour filter.