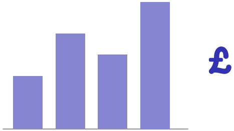
Finance & Accounting

A-Level Business ▪ Topic 5

A-Level Business



What we will cover

1. Why finance & cash vs profit
2. Sources of finance
3. Cash-flow forecasts
4. Costs
5. Break-even & budgets
6. Recap

1 Finance basics

Spending and working capital

Capital spending buys assets that last (a van, a machine). **Revenue** spending is day-to-day (wages, stock). **Working capital** 营运资本 = current assets − current liabilities – the cash to keep trading.

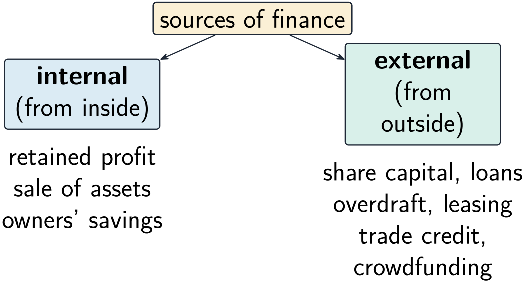
Cash is not the same as profit

Profit is revenue minus costs in a period. Cash is money in the bank. A profitable firm can still run out of cash if customers pay late or it buys a machine.

> Cash flow keeps the business alive this month. Profit is why it is worth running.

2 Sources and cash flow

Sources of finance



Internal 内部来源 (**retained profit** 留存利润, asset sales) vs **external** 外部来源 (**share capital** 股本, **loan** 贷款, **overdraft** 透支, **leasing** 租赁).

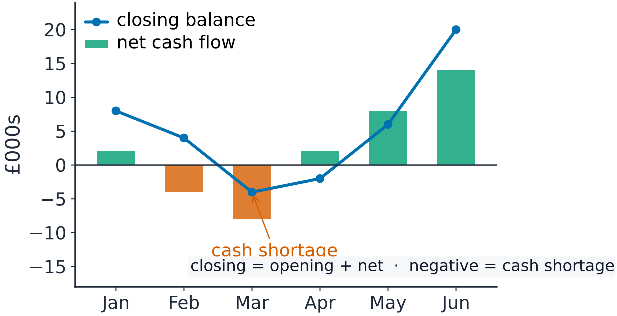
> Choose by amount, purpose, cost, structure & **collateral** 抵押品.

Where the money comes from

Why it is needed	**Business finance** 企业融资 is the money a firm needs to start, run and grow – **premises** 经营场所 and equipment to begin with, projects to grow, and day-to-day bills always.
Internal sources	**Internal sources** 内部融资: retained profit, and the **sale of assets** 资产出售 the firm no longer needs. No interest, no lost control.
External, short	**External sources** 外部融资: an overdraft, or **trade credit** 商业信用 – paying a supplier after 30 days.
External, long	A bank loan, share capital, or **venture capital** 风险投资: money from investors into risky young firms, usually for a share of the business.

Match the term of the finance to the life of the asset: a 30-day credit for stock, a ten-year loan for a building.

Cash-flow forecasts



Net cash flow 净现金流 = inflows − outflows; add to the **opening balance** 期初余额 for the closing balance. Fix shortages: collect sooner, delay payments, arrange an overdraft, hold less stock.

Cash in, cash out – and what a forecast is for

Cash inflows	**Cash inflows** 现金流入: money coming in, mostly from sales.
Cash outflows	**Cash outflows** 现金流出: money going out – wages, rent, suppliers, tax.
The net position	Inflows minus outflows gives the net cash flow; add the opening balance for the closing balance.
What it shows	*When* the firm will run short – months before it happens, while an overdraft can still be arranged.

> A profitable business can still fail: profit is a measure over a year, cash is a balance on a Tuesday.

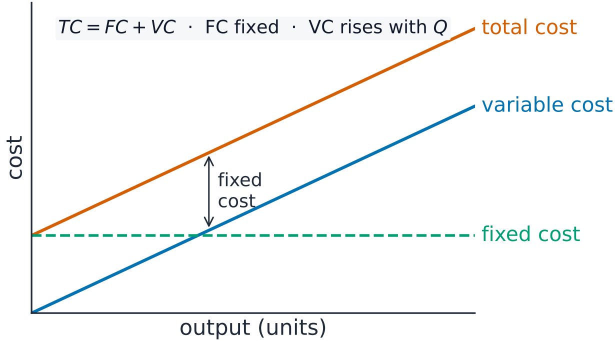
Cash-flow trouble: causes and cures

causes	too many sales on credit, too much stock, too many assets bought at once, or overtrading
bring cash in	ask customers to pay faster, or discount for quick payment
push cash out later	negotiate longer credit from suppliers; lease rather than buy
the balance	working capital management keeps enough cash to be safe without leaving money idle

> A **cash-flow forecast** 现金流量预测 is worth making because it shows the shortage BEFORE it arrives.

3 Costs and break-even

Costs



total cost = fixed + variable.

- **fixed** 固定成本 (rent) vs **variable** 可变成本 (materials)
- **direct** 直接成本 vs **indirect** 间接成本 (overheads)

How costs are classified, and why

a cost 成本	money the business spends to make its product
fixed and variable	fixed do not change with output; variable rise with each unit made
direct costs 直接成本	traceable to one product – the materials in it, the labour on it
indirect costs 间接成本	overheads not linked to one product – manager salaries, rent, insurance
average cost 平均成本	total cost divided by output – the figure that falls with economies of scale
why classify at all	cost information helps managers set prices, choose what to make, and control spending

> The same cost can be fixed *and* indirect, or variable *and* direct. The two classifications answer different questions and are not alternatives.

Break-even analysis

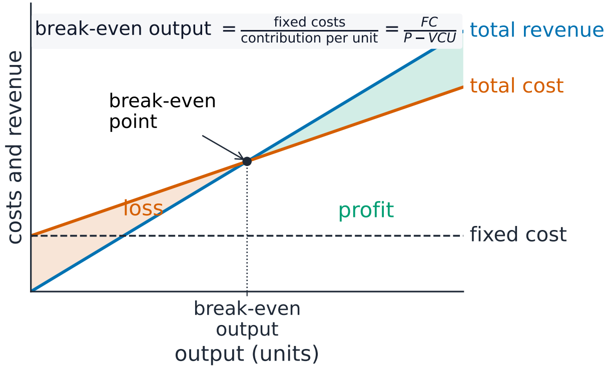
Contribution 贡献 $=$ price $-$ variable cost.

$$\text{BEP} = \frac{\text{fixed costs}}{\text{contribution}}.$$

Price £20, VC £12, FC £40,000

contribution £8 $\Rightarrow$ BEP $= 5000$ units

Break-even analysis, in detail



The break-even point is where total revenue equals total cost – left of it is loss, right of it is profit

Costs, and what break-even cannot tell you

Variable costs	**Variable costs** 变动成本 rise and fall with output – raw materials, piece-rate wages.
Marginal cost	**Marginal cost** 边际成本: the cost of making *one more* unit, which is what a pricing decision at the margin turns on.
Favourable variance	A **favourable variance** 有利差异 is better for profit – costs lower, or revenue higher, than the budget planned.
Limitations	Break-even's **limitations** 局限性: it assumes the selling price and the costs stay the same, and that everything made is sold.

> It is a planning tool, not a forecast. Its answer is exactly as good as the two straight lines it draws.

Budgets and variances

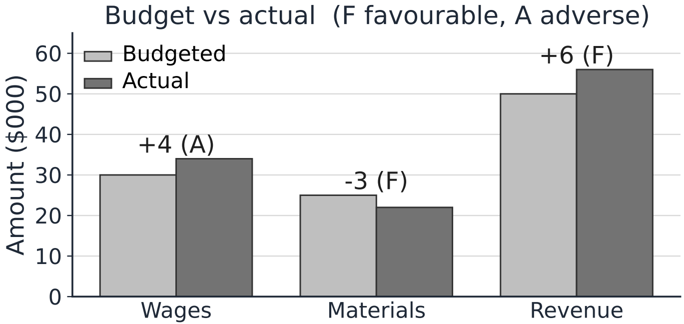
A **budget** 预算 is a financial plan. A **variance** 差异 = actual − budgeted.

- **favourable** 有利差异 – better for profit
- **adverse** 不利差异 – worse for profit

Wages: budget £30k, actual £34k

variance = £4k adverse

Variance = actual − budget



Exam: variance = actual − budget · cost under-spend = F; revenue under-earn = A

> Variance = actual − budget: cost overspend is adverse; revenue over-earn is favourable

Cash is not the same as profit, continued

a firm can be profitable but still run out of cash

profit (on paper)
revenue − costs
= positive

cash (in the bank)
low — customers
haven't paid yet

> Profit and cash are different: a firm can look profitable on paper yet have no cash to pay its bills – which is why many fail

Capital and revenue expenditure

capital expenditure

fixed assets that last (machines, vehicles, buildings)

revenue expenditure

day-to-day running (wages, rent, materi- als)

Capital spending buys fixed assets; revenue spending covers running costs

Two kinds of spending, and the working-capital test

capital expenditure 资本支出	buying long-lived assets – machinery, vehicles, buildings. Appears on the **balance sheet** 资产负债表
revenue expenditure 收益支出	day-to-day running costs – wages, rent, materials. Charged against this year's profit
working capital 营运资本	current assets minus current liabilities
current assets 流动资产	things that become cash within a year – cash, inventory, money owed by customers
current liabilities 流动负债	debts due within a year – suppliers, overdraft, tax due
why it matters	a profitable firm with no working capital still cannot pay its bills

> Cash is not profit. A firm fails when it runs out of cash, whatever the profit statement says.

Choosing a source of finance

match the finance to the purpose

short-term need
stock, a cash gap

→

short-term finance
overdraft, trade credit

long-term asset
machinery, premises

→

long-term finance
a long loan, shares

also weigh the **cost**, the amount, the legal structure and any **collateral**

don't pay for a long-lived asset with short-term borrowing

> Match the finance to the purpose: short-term needs use short-term finance, long-term assets use long-term finance

What decides which source to use

the purpose	a long-lived asset needs long-term finance; a cash-flow gap needs an overdraft
the amount	a small sum from retained profit, a large one from shares or a bank
the cost	interest and fees differ sharply between sources
existing debt	how much the firm already owes – its **gearing** 负债比率
collateral 抵押品	an asset the lender can take if the loan is not repaid – without one, borrowing is dear or impossible
control	issuing shares raises money and dilutes ownership

There is no single best source. Every answer must name the firm's situation – purpose, size, gearing, ownership – before it names a source.

Sources of finance, continued

A stock exchange: public limited companies raise finance by selling shares

More sources of finance

hire purchase 分期付款	external – buying an asset by paying in instalments, owning it at the end
leasing	external – renting the asset; never owned, but no large payment up front
crowdfunding 众筹	external – small amounts raised from many people online
microfinance 小额信贷	external – small loans for people with little access to banks
debentures 债券	external – long-term loans that pay fixed interest, repaid at a set date
retained profit	internal – the cheapest source there is, and the one with no strings

> Sort every source into internal or external and short or long term first. Those two axes answer most of the question before you consider cost.

Budgets and variances, continued

actual − budget

budget plan: £30,000 → **actual** spent: £34,000 → **variance** $= +\pounds 4{,}000$

favourable: helps profit
(spend less, or earn more than planned)

adverse: hurts profit
(spend more - as in this wages example)

a **budget** is a financial plan; the **variance** shows how far the actual result missed it

> A variance is actual minus budget; favourable helps profit, adverse hurts it

Two ways to build a budget

incremental budget 增量预算	last year's figures changed by a small amount – quick, and it carries forward old waste
zero-based budget 零基预算	every cost must be justified from zero each year – thorough, and slow
a variance 差异	actual minus budget
favourable 有利差异	revenue above budget, or costs below it
adverse 不利差异	revenue below budget, or costs above it
why analyse them	a variance shows managers where the plan went wrong, so they can act

An adverse variance is not automatically bad management: a cost overrun caused by *higher than budgeted sales* is good news. Say what caused it.

Working capital

Cash is working capital: firms need enough liquid assets to pay day-to-day bills

Exam tips

- Show that **cash is not profit** – a profitable firm can still fail from a cash-flow shortage.
- For **break-even**: contribution per unit = price − variable cost; break-even = fixed costs ÷ contribution; margin of safety = actual − break-even output.
- Match a **source of finance** to the need (short-term for cash flow, long-term or equity for assets) and to the type of business.
- Calculate a **variance** and label it **favourable or adverse** (actual against budget).

4 Recap

Topic 5 – key takeaways

1. **Cash vs profit**

   a profitable firm can still run out of cash

2. **Sources**

   internal vs external; short vs long

3. **Break-even**

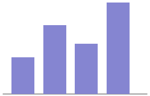
   BEP = fixed costs / contribution

4. **Budgets**

   variance = actual − budgeted

Check yourself

1. Can a profitable firm run out of cash?
2. Retained profit: internal or external finance?
3. Contribution if price £15, variable cost £9?
4. Higher-than-planned costs: favourable or adverse?



Answers **1.** yes **2.** internal **3.** £6 **4.** adverse