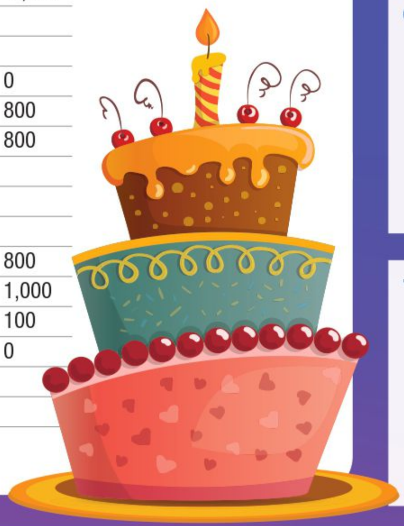
COMPONENT 3 LEARNING AIM C

tutor2u

BUSINESS PROFILE

Rita has recently set up a cake business and has presented her partially completed cash flow forecast to the bank as follows:

£	May	June	July	Aug	Sep	Oct
Opening bank balance	500	-4,800	-6,000	-6,100	-6,200	-6,500
Receipts						
Loan	5,000	0	0	0	0	0
Cash sales	0	800	1,200	800	1,000	800
Credit sales	0	0	600	1,000	600	800
Total receipts						
Payments						
Purchases of stock	4,000	800	800	800	800	800
Wages	1,000	1,000	1,000	1,000	1,000	1,000
Telephone bills	300	200	100	100	100	100
Shop and fixtures	5,000	0	0	0	0	0
Total payments						
Closing bank balance	-4,800	-6,000			-6,800	



START

1 Define what is meant by 'cash flow'.

2 Identify three inflows and three outflows of Rita's cake business.

3 Define what is meant by fixed and variable costs.

4 Identify which of the following are fixed and variable costs: business rates, insurance, electricity, raw materials, telephone line rental, fuel.

5 Outline how you would calculate total fixed costs and the variable cost per unit.

6 Outline how you calculate the break-even point of a business.

7 Rita has calculated that her average selling price will be £2 and her variable cost per product will be 75p. She has calculated her fixed costs at £4000. **Calculate** the break-even point for Rita's business.

8 Identify which of the following are internal and external sources of finance: owner funds, retained profits, loans, credit cards, government grants, hire purchase and leasing, trade credit, venture capital, peer-to-peer lending.

9 *Assess* the factors Rita's business would need to consider before taking out a source of finance.

10 Calculate the total receipts and total payment rows for Rita's cash flow forecast.

11 Calculate the closing bank balance for July, August and September.

12 Assess the state of Rita's cash flow forecast and how this may affect the business.

13 Assess suitable courses of action for Rita's business based on the cash flow forecast.

14 Rita is considering taking out a bank loan to expand her business. **Evaluate** whether this option is suitable for Rita's cake business.

COMPONENT 3 LEARNING AIM C SUGGESTED ANSWERS

1 *Define what is meant by 'cash flow'.*

The cash flow is the total amount of money being transferred into and out of a business.

2 *Identify three inflows and three outflows of Rita's cake business.*

Inflows: Cash sales, credit sales, loans. Outflows: raw materials, utilities, supplier payments, equipment,machinery.

3 *Define what is meant by fixed and variable costs.*

Fixed costs are costs that do not change with the level of output of a business. Variable costs change as output varies.

4 *Identify which of the following are fixed and variable costs: business rates, insurance, electricity, raw materials, telephone line rental, fuel.*

Fixed costs: business rates, insurance, telephone line rental.

Variable costs: electricity, raw materials, fuel.

5 *Outline how you would calculate total fixed costs and the variable cost per unit.*

Fixed costs = total costs - total variable costs.

Variable cost per unit = total variable costs/ number of units.

6 *Outline how you calculate the break-even point of a business.*

Breakeven = Fixed costs/selling price per unit - variable cost per unit.

7 *Rita has calculated that her average selling price will be £2 and her variable cost per product will be 75p. She has calculated her fixed costs at £4000. Calculate the break-even point for Rita's business.*

£2-0.75 = 1.25. 4000/1.25 = 3200 units

8 *Identify which of the following are internal and external sources of finance: owner funds, retained profits, loans, credit cards, government grants, hire purchase and leasing, trade credit, venture capital, peer-to-peer lending.*

Internal sources of finance: owner funds, retained profits.

External sources of finance: loans, credit cards, government grants, hire purchase and leasing, trade credit, venture capital, peer-to-peer lending.

9 *Assess the factors Rita's business would need to consider before taking out a source of finance.*

Rita would need to consider the liquidity of the business, cash flow position, type of finance suitable for the business, the length of term required, the cost of the source of finance, availability of the source of finance and the advice available with each source of finance.

10 *Calculate the total receipts and total payment rows for Rita's cash flow forecast.*

£	May	June	July	Aug	Sep	Oct
Total receipts	5,000	800	1,800	1,800	1,600	1,600
Total payments	10,300	2,000	1,900	1,900	1,900	1,900

11 *Calculate the closing bank balance for July, August and September.*

July (£6,100), August (£6,200) and September (£6,500).

12 *Assess the state of Rita's cash flow forecast and how this may affect the business.*

The business has a poor cash flow. The business does not run a surplus in any of the months forecasted. The business has significant start up costs in the first month which adversely affect the business' cash flow from the beginning. Sales are not high enough to meet the demands of outflows in the other months. The business also takes too long to collect payments from customers (credit sales). In addition, the business lacks adequate start up finance. Ultimately the business will run out of money and suppliers may refuse to supply the business, therefore the businesss may cease to trade.

13 *Assess suitable courses of action for Rita's business based on the cash flow forecast.*

Increase inflows by increasing sales or source of finance. Reduce the outflows by cutting costs, finding cheaper suppliers.

14 *Rita is considering taking out a bank loan to expand her business. Evaluate whether this option is suitable for Rita's cake business.*

Advantages: no equity lost, no loss in control of ownership or decision making, potential access to large sums of money.

Disadvantages: need a good credit rating to access cheapest loans, which is not always possible for a start up business. Collateral against the loan may be required. Loan acts as a liability, affecting the valuation of the business. Monthly ongoing cost for the loan repayments each month.

TIME TO REVIEW YOUR LEARNING...

List three content points that you are confident with and three that require some attention.

Confident with	Requires attention
1	1
2	2
3	3