

Unit 2: Finance for Business

Level: **1 and 2**

Unit type: **Mandatory**

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 breakeven point – the point at which sales equal costs (fixed and variable). All sales over the breakeven point produce profits, while any drop in sales below that point will produce losses. You will be introduced to the benefits of breakeven 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 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 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 how businesses make money (generate revenue)
- understand sources of revenue for a business
- calculate revenue (formula will not be given in the assessment)

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

- understand how businesses have to spend money (expenditure) in order to succeed
- understand 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)
- understand from a breakeven chart:
 - breakeven point
 - profit
 - loss
 - variable costs
 - fixed costs
 - total revenue
 - total costs
 - margin of safety
- calculate the breakeven (formula will not be given in the assessment)

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

- understand the advantages and disadvantages of breakeven analysis to businesses when planning for success
- understand the effect on the breakeven point if sales or (fixed and variable) costs change, and 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:

- understand the purpose of a cash flow forecast
- understand the sources of cash coming into the business (inflows)
- understand the sources and destination of cash leaving the business (outflows)
- understand the impact of timings of inflows and outflows
- understand the advantages of using a cash flow forecast to plan for success in a business and explain the associated risks to businesses of not completing a cash flow forecast
- understand the disadvantages of cash flow forecasting
- complete a cash flow forecast from given information
- understand business' finances based on cash flow information and possible issues and solutions for the business.

What needs to be learnt**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:

- understand cost of sales
- understand gross profit
- calculate gross profit (formula will not be given in the assessment)

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

- understand the impact of positive and negative gross profit on businesses
- understand net profit
- calculate net profit (formula will not be given in the assessment)

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

- understand 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:

- understand the purpose of a income statement (profit and loss account)
- understand and 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
 - calculates the amount of gross profit
 - expenses/overheads (bottom section of the income statement)
 - calculate net profit.
- understand profitability ratios (formulas will not be given in the assessment)
 - gross profit margin

$$\text{Gross Profit Margin} = \frac{\text{Gross profit}}{\text{Sales}} \times 100$$

- net profit margin

$$\text{Net Profit Margin} = \frac{\text{Net profit}}{\text{Sales}} \times 100$$

continued

What needs to be learnt

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

- understand the purpose and format of a statement of financial position (balance sheet)
- understand assets and liabilities
 - fixed assets
 - current assets
 - long-term liabilities
 - current liabilities.
- understand and complete a statement of financial position (balance sheet) with given figures, including:
 - assets
 - liabilities
 - capital – how the business is funded (money invested in the business to generate revenue) from:
 - internal sources – money from owners/shareholders (share capital) or retained profits
 - external sources – finance raised from outside of the business
 - working capital (formula will not be given in the assessment)

$$\text{Working Capital} = \text{Current assets} - \text{Current liabilities}$$

- understand liquidity ratios (formulas will not be given in the assessment)
 - current ratio

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

- liquid capital ratio

$$\frac{\text{Current assets} - \text{Inventory}}{\text{Current liabilities}}$$

Topic C.2 Understand how businesses can be more successful

Learners should:

- understand ways in which a business can increase profits
- understand financial statements and actions that arise from these statements.

Teacher guidance

Resources

There are no special resources needed for this unit.

Essential information for assessment

This unit is externally assessed using an onscreen test. Pearson sets and marks the test. The first assessment date for the revised Unit 2 onscreen test for the 2018 specification is Jan 2020. Candidates may access the legacy 2012 onscreen test prior to this date. The assessment lasts for 1 hour 15 minutes and contains 60 marks.

The assessment must be taken by the learner under examination conditions.

All questions in the onscreen test are compulsory. There will be different types of objective, short answer and extended writing questions.