

Revenue and costs

1	Sales volume	The total number of units sold by a business	Volume = sales revenue / price
	Sales revenue	The total money received from selling a businesses products before any costs are deducted	Sales revenue = Price x Quantity sold
	Average costs	The cost per unit of output	Average Cost = Total cost / Quantity
	Fixed costs	Costs that do not change with output/sales	
	Variable cost	The cost of making one unit. To calculate total variable costs you multiply the variable cost of one unit by the number of units produced/sold.	Total variable cost = Variable cost per unit x output

Importance of profit

The profit signalling mechanism can act as an incentive to enter and exit a market. If a market is seen as profitable, then this is a flag to other producers to enter the market in order to seek profits.
The ease of entry and exit depends on the barriers to entry for each individual market.
Profit can be retained and reinvested in the business to help with expansion and developing the product/business

Relationship between revenues and costs

Concept	Formula
Breakeven point – The point at which the businesses total costs are equal to total revenue or when neither a profit or a loss is made	$\frac{\text{Fixed Cost}}{\text{Price} - \text{variable cost}}$
Margin of safety – How far actual units sold is above the breakeven point	Actual output – breakeven output
Contribution – The difference between price and variable costs. Shows the contribution to fixed costs after variable costs have been deducted when one unit is sold	Price – variable cost

Evaluating breakeven

Advantages	Disadvantages
Focuses entrepreneur on how long it will take before a start-up reaches profitability – i.e. what output or total sales is required	Unrealistic assumptions – products are not sold at the same price at different levels of output; fixed costs do vary when output changes
Helps entrepreneur understand the viability of a business proposition, and also those who will lend money to, or invest in the business	Sales are unlikely to be the same as output – there may be some build up of stocks or wasted output too
Margin of safety calculation shows how much a sales forecast can prove over-optimistic before losses are incurred	Variable costs do not always stay the same. For example, as output rises, the business may benefit from being able to buy inputs at lower prices (buying power), which would reduce variable cost per unit.
Helps entrepreneur understand the level of risk involved in a start-up	Most businesses sell more than one product, so break-even for the business becomes harder to calculate
Calculations are quick and easy – great for giving quick estimates	Break-even analysis should be seen as a planning aid rather than a decision-making tool

Profit and loss

The statement of comprehensive income (profit and loss account)	It shows the profit or loss made by the business – which is the difference between the firm's total income and its total costs over a period of time (normally 12 months)	
Gross profit	Revenue – Cost of sales	Gross profit margin = $(\text{Gross profit} / \text{revenue}) * 100$
Operating profit	Gross profit – expenses	Operating profit margin = $(\text{Operating profit} / \text{revenue}) * 100$
Net profit	Operating profit – (tax + interest)	Net profit margin = $(\text{Net profit} / \text{revenue}) * 100$

Relationship between revenues and costs

Cashflow forecast	<p>The movement of cash into and out of a business. It is a dynamic and unpredictable part of life for most businesses.</p> <p>Cash flow problems are the main reason why a business fails</p>
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CASHFLOW PROBLEMS

Causes	Solutions
Too much spending on production capacity	Increase sales with discount prices (increases income)
Excessive stock held	Sell assets (increases income)
Allowing customers too much credit or too long to pay	Get an overdraft or loan (increases income)
Overtrading – growing the business too fast	Chase debtors who haven't paid yet (increases income)
Seasonal demand	Reduce purchases (Reduces costs)
	Negotiate credit from suppliers and delay bill payments (Reduces costs)
	Debt factoring: sell the debt to a 3rd party (better some of it now than all of it later) (Reduces costs)

Why produce a cashflow forecast?

Advanced warning of cash shortages
Makes sure that payments are made on time
Important part of financial control
Reassures lenders and investors. Needed when applying for credit e.g. bank loan

Key vocabulary

Inflows	Total cash coming into the business
Outflows	Total cash leaving the business
Net cashflow	The difference between inflows and outflow
Opening balance	Cash in the business at the start of the month
Closing balance	Opening balance + net cashflow
Trade credit	Trade credit is the credit extended to you by suppliers who let you buy now and pay later.

	Jan	Feb	Mar
CASH INFLOWS			
Investment	10,000		
Credit sales	2,500	10,000	10,000
Total inflows	12,500	10,000	10,000
CASH OUTFLOWS			
Project materials		3,000	3,000
Sub-contract labour	4,000	4,000	4,000
Marketing	500	500	500
Legal and accounting	1,250	0	0
Equipment	2,500	0	0
Sophie & Jack salaries	1,000	1,000	1,000
Other costs	500	500	500
Total outflows	9,750	9,000	9,000
NET CASH FLOW	2,750	1,000	1,000
Opening balance	0	2,750	3,750
Closing balance	2,750	3,750	4,750