Beckfoot

Subject: Business 9-1	Topic: Making Financial Decisions 2.4	Year Group: 11

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Profit

Key Idea	The **profits** made by a business consist of the money that is left over once all of the expenses incurred in running the business have been paid.
Basic Formula for Profit	Total Revenue – Total Costs
Different types of Profit	Gross Profit Net Profit
Costs	Businesses usually separate their costs into **variable costs** and **fixed costs** **Variable costs change with output** **Fixed costs stay the same no matter how many products the business sells**
Gross Profit	Gross profit is the difference between the money received from selling goods and services and the cost of making or providing them. It ignores any fixed costs, or **overheads**, so it is useful in showing how much profit each product or service generates.
Gross Profit Calculation	*Gross profit = sales revenue − cost of sales*
Net Profit	**Net profit** is the difference between the amount of money received from selling goods and services and **all** of the costs incurred in order to make them. Net profit is often considered to be the more important **profit** figure, as it includes all of the **fixed costs** and other **overheads** that a business has to pay.
Net Profit Calculation	*Net profit = gross profit − other operating expenses and interest*

Gross Profit Margins

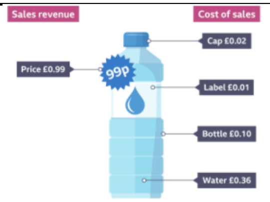
Key Idea	**Profit** calculations alone are of limited use. While **gross profit** can be compared over time to see whether products have become more or less profitable, additional information is needed to assess whether a business has performed well.
Key Idea	In order to better assess the performance of a business, it is necessary to calculate the **profit margin**. Profit margin is the amount of profit expressed as a percentage of sales revenue. Since there are two different measures of profit, there are also two different types of profit margin: gross profit margin and **net profit margin**
Gross Profit Margin	The **gross profit margin** is the percentage of sales revenue that is left once the **cost of sales** has been paid. It tells a business how much gross profit is made for every pound of sales revenue received. For example, a gross profit margin of 75% means that every pound of sales provides 75 pence of gross profit.
Gross Profit Margin Calculation	Gross Profit/ Sales Revenue X 100
Using the gross profit margin	Comparing gross profit margins over time can be useful for businesses. In the example above, the gross profit margin decreased despite the fact that the sales revenue tripled and gross profit doubled. This indicates that the cost of sales, which includes raw materials, increased faster than the business increased the price it charged its customers. This business might respond by increasing the price that it charges its customers or by negotiating lower prices for raw materials with its suppliers.

Net Profit Margins

Key Idea	The **net profit margin** is the proportion of **sales revenue** that is left once all costs have been paid. It tells a business how much **net profit** is made for every pound of sales revenue received. For example, a net profit margin of 32% means that every pound of sales provides 32 pence of net profit.
Net Profit Margin Calculation	Net Profit / Sales Revenue X 100
Using the net profit margin	**Comparing the net profit margin with the gross profit margin** - By comparing the net profit margin with the gross profit margin for the same time period, a business can identify how significant its fixed costs, or **overheads**, are. For example, a business that has a gross profit margin of 50% and a net profit margin of 10% knows that for every pound of goods sold, 40 pence is used to pay fixed costs. This can then be used to identify whether there is any scope to reduce these fixed costs. **Comparing net profit margins over time** - By comparing net profit margins over time, a business can identify what is happening to its costs. For example, a decrease in net profit margin indicates either that sales revenue has fallen faster than costs or that costs have increased faster than sales revenue.

The net profit per day is:

£5,000 – £4,525 = £475



The gross profit on each bottle of water is:

£0.99 – £0.49 = £0.50

The total gross profit is:

£0.50 × 10,000 bottles = £5,000 per day

Average Rate of Return

Key Idea	The average rate of return is a way of comparing the profitability of different choices over the expected life of an investment. To do this, it compares the average annual profit of an investment with the initial cost of the investment. This is necessary in order to compare investments that might last for different periods of time.
Kay Idea	Businesses often have to make investment decisions. This might involve deciding which piece of equipment or machinery to buy, or whether to move to bigger premises. Any investment is made in the hope that in return the business will see its profits increase.
ARR calculation	Average Annual Profit / Cost of Investment X 100
Average Annual Profit calculation	Total Profit / number of years

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Information from graphs and charts

Key Idea	Businesses have access to a lot of numerical information, also called **quantitative** information. Businesses often use this information to help them make business decisions. Such information might be available in internal documents, such as sales reports or financial documents, and other information might come from external sources, such as government statistics.
Quantitative Data	This is data or information that is presented by numbers like statistics
Charts	A chart is used to present information in the form of a graph, a diagram or a table. There are many different types of chart, including **pie charts**, **bar charts**, **pictograms** and **infographics**.
Graphs	A graph is a specific type of chart that illustrates a relationship between two or more **variables**. These are often plotted on two axes, vertical and horizontal. All graphs are types of chart, but not all charts are graphs.
Reading data from graphs and charts	When extracting information from charts and graphs, it is important to: • identify any trends the graph or chart shows • check the scales used on the **axes** • be aware of whether the data show units, **percentages** or **percentage change** • read the chart title and any labels used

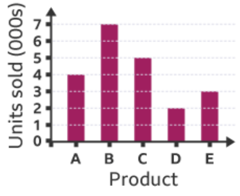
Financial Data

Key Idea	The financial position of a business is crucial to all decisions that it makes. Using financial information, a business should be able to identify what options it can afford when making decisions. This financial data can be used to forecast how decisions might affect the business' **cash flow** and assess any impact on future **profits**.
Costs and revenues	A business should be aware of what is happening to its **total costs** and **revenues**, and how well it is able to control them. This makes it easier to forecast what might happen in the future.
Gross and net profit	Identifying what is happening to costs and revenues enables a business to calculate how this might affect both **gross profit** and **net profit**, using historical profit information.
Profit Margins	**Profit margins** can be calculated and compared either to the business' previous figures or to competitors' figures. They can help a business to understand what is causing any change in its profit levels.
Cash Flow	Businesses need access to cash in order to survive. Accurately forecasting the cash flow in and out of a business is crucial when deciding what a business can and cannot afford to do.
Break Even	Knowing the **break-even** point in the business' output is important when making decisions about which products to make. It can help a business to avoid making unprofitable products.
Average Rate of Return	Whenever investment decisions are required, a business will want to compare the expected returns from the options available. Calculating the **average rate of return** for each project enables a business to do this. This helps the business to identify the most **profitable** options.

Benefits of using financial data	• Making use of financial data often requires the use of percentages and percentage change calculations over time. This enables a business to see trends and make comparisons, which can be helpful when making decisions. In addition, this data can be useful when communicating with **shareholders** or potential lenders about the performance of a business.
Limitations of using financial data	• Financial data can only be used after it has been collected, meaning that it is always out of date. While it can give insights into how a business has performed, it cannot predict the future. Business owners must take this into consideration when using company accounts to make big decisions. • When making decisions, a business owner should ensure that they are using a sufficient time period of information and a wide range of sources. • Another limitation of financial data is the fact that statistics and data can be interpreted differently using different methods, which can lead to different conclusions being drawn. • The final limitation of using financial data is that it only shows how successful a business is in financial terms. Financial success is not the only indicator of business success, although to many businesses it is the most important. Some businesses judge their success in terms of their environmental impact or according to their ethical aims.

Shoe design	A	B	C	D	E
Shoe size 1	3	1	NA	4	1
Shoe size 2	1	2	2	5	NA
Shoe size 3	6	3	1	3	2
Shoe size 4	NA	1	NA	1	1
Shoe size 5	5	NA	2	3	NA
Shoe size 6	5	2	NA	4	1
Shoe size 7	NA	NA	1	2	NA

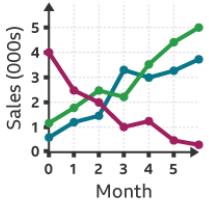
Table



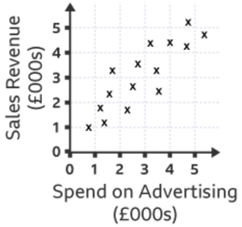
Bar chart

Pie chart

Diagram



Line graph



Scatter diagram

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Marketing Data

Key Idea	**Marketing** data can provide a variety of **quantitative** and **qualitative** information. This data often comes from **market research**, which can be used to obtain both **primary data** and **secondary data**. All of this information can be invaluable when making business decisions.
Key Idea	Marketing data can provide sales forecasts and promotional plans that may affect other areas of a business. For example, if a business is planning to promote a product, it will need to ensure that its production departments can cope with any anticipated increase in sales.

Market Data

Key Idea	Market data refers to information about the characteristics that make up a particular market. It includes both **economic** and **demographic** factors. These factors may affect the behaviour of consumers within the market and the level of demand for products and services.
Economics Factors	Economic factors relate to money and wealth. They include: 1. consumer incomes 2. exchange rates 3. interest rates 4. inflation rate 5. unemployment rates.
Demographic Factors	Demography refers to the composition of the population. Demographic data is useful for business decision-making as it can tell businesses about changes in population size, migration and population structure. 1. Age 2. Income 3. Gender 4. Ethnicity 5. Marital status 6. Education 7. Employment status

Understanding Business Performance

Key Idea	There are a number of ways to measure business performance: • changes in costs • changes in revenue • gross profit • net profit • gross profit margin • net profit margin
Key Idea	Most of the information required to analyse the performance of a business is contained within its **accounts**. Particular care is required if this information is used to compare the performance of one business against another business. This is because different businesses might have different accounting periods

Making Business Decisions

Key Idea	Businesses make decisions using the information that they have available. It is important to ensure that any information used is: • accurate • sufficient • up to date
Accurate	Information used to make decisions needs to be accurate and complete. Inaccurate or incomplete information is likely to lead to incorrect business decisions being made. The consequences of this could be serious, potentially leading to a business failing.
Sufficient	One set of data, particularly financial data, can be meaningless unless put into context. This might mean comparing it with historical data or data from similar businesses. This is particularly true for seasonal **goods** and **services**, such as ice cream, where comparing sales in the summer months against sales in the winter months would not give a realistic growth figure for the business.
Up to date	Information needs to be kept up to date to ensure that it remains relevant. It is not just the passing of time that makes information go out of date. Any significant changes in the market can make data less useful. For example, the emergence of a new competitor would make historical market share data less useful.
Other limitations	Even when the information used to make decisions is accurate, sufficient and up to date, the way that such information is used may have limitations. For example, the **average rate of return** is often used to help a business make decisions by comparing the profitability of different investment options. However, this technique does not consider the effects of inflation on the value of cash