Topic 1.3
Putting a business idea into practice
1.3 THEME 1 INVESTIGATING SMALL BUSINESS – CONCEPT MAP

How small business interacts with the wider world

- Technology and business
- Understanding external influences
- Business response to external influences
- The economy and business

Three phases of development of a new small business

- Market research
- Competitive environment
- Business revenue, costs and profits
- Sources of business finance
- Business location
- Business plans

- Scoping a business opportunity
- Putting ideas into practice
- Making the business effective

- Customer needs
- Market segmentation
- Business aims and objectives
- Cash and cash flow
- Options for start-up or small business
- Marketing mix

Why and how small businesses start

- Enterprise and entrepreneurship
- Role of business enterprise
- Risk and reward
- Dynamic nature of business
Focus on these areas as a minimum

Business Ideas
Unique selling point
Market research
Market Mapping
Marketing Segmentation
Competitive environment
Cash Flow
Trade credit
Sole Trader
Marketing Mix
Business Stakeholders
Technology and Business

Exam Sections

Section A
In this section you will be tested on your knowledge of business. 35 marks are available and the highest mark on a question is:

“Discuss” 6 marks

Section B
In this section you will be tested on your knowledge of business applied to a case study. 30 marks are available and the highest marks on the question is:

“Analyse” 6 marks
“Justify” 9 marks

Section C
In this section you will be tested on your knowledge of business applied to a case study. 25 marks are available and the highest marks on the question is:

“Justify” 9 marks
“Evaluate” 12 marks

Answering questions

Command words are the part of the question which tell you what to do

<table>
<thead>
<tr>
<th>Command Word</th>
<th>What to do</th>
</tr>
</thead>
<tbody>
<tr>
<td>State or Give</td>
<td>These ask for a statement – you don’t need to back up with evidence.</td>
</tr>
<tr>
<td>Define</td>
<td>You need to write down what term means.</td>
</tr>
<tr>
<td>Identify</td>
<td>You need to interpret data shown on a graph or in a table to get your answer.</td>
</tr>
<tr>
<td>Calculate</td>
<td>Some questions ask for a bit of maths. Remember to show your working.</td>
</tr>
<tr>
<td>Complete</td>
<td>You need to fill in the missing parts of some information you’ve been given (e.g. complete a table).</td>
</tr>
<tr>
<td>Outline</td>
<td>You need to make two main points about a business issue and link them together.</td>
</tr>
<tr>
<td>Explain</td>
<td>You need to give reasons for things. So take a business issue, show how it impacts on other areas of business by giving reasons why.</td>
</tr>
<tr>
<td>Discuss</td>
<td>This is a longer version of an explain question, where you describe the business issue or issues and then explain the impact as per the Explain command word.</td>
</tr>
<tr>
<td>Analyse</td>
<td>This means ‘examine in detail’. You show describe and explain the main features of the ‘thing’ you’re analysing. The explain how the features of the ‘thing’ collectively impact on the business.</td>
</tr>
<tr>
<td>Justify</td>
<td>You’ll be given some information about a business and asked to recommend whether the business should do something or chose between two options for what the business should do. Each option needs to be Analysed.</td>
</tr>
<tr>
<td>Evaluate</td>
<td>You should discuss both sides of a business issue. Each side needs analysing. You should finish with a conclusion which gives an overall judgement.</td>
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</table>
AIMS AND OBJECTIVES

Aims are goals for business; they explain what a business wants to achieve in the long term.
Objectives are the short term steps the business takes to achieve its aims.
SMART: objective setting is often used to make sure that objectives/targets are SPECIFIC, MEASURABLE, ACHIEVABLE, REALISTIC and TIMELY.
A business sets aims and objectives:
- To share its direction with staff so they know what to focus on and are motivated to perform
- To enable a business to measure its performance
- To help a business plan for the future

FINANCIAL AIMS AND OBJECTIVES FOR DIFFERENT TYPES OF BUSINESSES

Private sector businesses often have aims and objectives that maximise their profit, market share or expand the business.
Private sector businesses are privately owned.
Public sector businesses are more likely to focus on delivering a service to customers and keeping running costs to a minimum.
Public sector businesses are run by the government for the benefit of society, e.g. schools, hospitals, the fire service.
Not-for-profit organisations, or charities, aim to fundraise or collect donations for specific causes, e.g. The Royal Society of Prevention of Cruelty to Animals (RSPCA)
Social enterprises use business techniques to sell products or services for profit, which is invested to benefit society or the environment rather than paid out to shareholders.
FINANCIAL AIMS AND OBJECTIVES

Financial aims and objectives typically relate to money. When a business starts trading, often its aim is survival, which means to be able to simply operate (survive) by meeting its costs in the beginning stages, which tend to be high. Many businesses aim to maximise profit. Some businesses aim to increase the volume of sales of products or services. Other businesses have an aim to increase their market share, which is the percentage of sales held by a business in a particular market. Some entrepreneurs begin a business to provide them with financial security and personal wealth.

NON-FINANCIAL AIMS AND OBJECTIVES

Non-financial aims and objectives relate to goals which are not money-related. Having a business with social objectives, e.g. providing goods and services that are kind to the environment or aim to eliminate poverty, is important for many organisations. Personal satisfaction is key for many business people. Many entrepreneurs aim to challenge themselves with new ventures. Some entrepreneurs aim for independence so that they don’t have to work for someone else. Having more control over their work/life balance might be an aim for some entrepreneurs.

QUICK TEST

1. Explain the difference between an ‘aim’ and an ‘objective’.
2. Explain why a business should set aims and objectives.
3. Explain the difference between ‘financial’ and ‘non-financial’ aims and objectives, giving an example for each type.
REVENUES, COSTS AND PROFIT

To be able to calculate profit, a business will need to know its revenue and its total costs. If a business can calculate these then it can also carry out some analysis by looking at what profit it will make at different sales levels. Revenue also referred to as sales revenue or turnover. It is the total amount of income made from selling a product or service.

REVENUE = SELLING PRICE X NUMBER OF UNITS SOLD.

Fixed costs are those that do not change in line with changes in output. An example would be advertising. Variable costs are those that change directly with the changes in output. An example would be raw materials.

TOTAL VARIABLE COSTS = VARIABLE COSWTS PER UNIT X NUMBER OF UNITS

Profit is made when the revenue received exceeds the total cost. If a business has total costs that are greater than revenue it is called LOSS.

PROFIT = REVENUE – TOTAL COSTS

INTEREST

Sometimes a business needs to raise finance by borrowing money. This borrowing can come from friends or family who are willing to help, or from a bank. The business will probably have to pay an interest rate on the money borrowed. Interest rates charged are expressed as a percentage per year (per annum), e.g. 2% p.a., so for example if a business borrows £10000 for one year at 2% p.a., it will need to repay the bank £10200 at the end of the year. A business may make enough profit to put some cash into a savings account with a bank which pays interest – this is often a way for businesses to earn extra revenue as the interest it receives on its saving provides more income. To calculate interest rate charged on a loan is:

(TOTAL REPAYMENT – BORROWED AMOUNT)/BORROWED AMOUNT X 100

BREAK EVEN

A business will break even when it sells enough products to generate sufficient revenue to cover its total costs. A new business must know how much it needs to sell so that it can ensure that the business is viable. A break even analysis is used to aid a business in making decisions about what price to charge, how much to produce and to help managing costs. The break even level of output is the number of products that a business needs to sell in order for revenue to equal total costs. BREAK EVEN = FIXED COSTS/(SELLING PRICE-VARIABLE COST PER UNIT). Break even analysis is useful for new start-up businesses as it shows if they are viable. They will know how many products or services they need to sell to cover their costs. They can then decide if this is achievable. Break even can be used for a ‘what if’ analysis. A business can change the variables which will show changes in profit levels. This helps with price, production and cost decisions.
CASH FLOW

Cash flow is the flow of cash in and out of the business. Cash inflow is cash paid into a business from a variety of sources, e.g. sales, payments from customers, bank interest, sale of assets, bank loan capital. Cash outflow is cash paid out of a business, e.g. suppliers, wages, loan repayments, overheads, advertising costs. A cash surplus (known as a positive net cash-flow) is when a business experiences more cash outflows than cash inflows over the same period. A cash deficit is when a business experiences more cash outflows than inflows over the same period (also known as a negative cash-flow).

Cash flow is critical to the survival of a business. Having too little cash when bills are due is called insolvency, which means that the business will fail if it doesn’t pay its bills on time. Having too much cash means the business is not earning any return, so it would be best to invest the money in new machinery or increase production or put it into a savings account that pays interest.

DIFFERENCE BETWEEN CASH AND PROFIT

Cash is about timing – it is simply a record of when a business’s cash inflows and outflows are due.

Profit is total revenue minus total costs and is calculated immediately after a sale.

A business may be highly profitable but if it does not have sufficient cash to pay its bills when they are due it risks becoming insolvent, leading to business failure.

CASH FLOW FORECAST

Cash inflows and outflows are rarely the same amount each month so cash levels in a business fluctuate. Cash flow forecasts show future cash inflows and outflows and are normally shown on a weekly or monthly basis. The opening balance for each month is the same amount as the closing balance from the previous month. A cash flow forecast can help a business by:

- Predicting when cash flows in and put SO business can financially plan ahead to reduce unexpected cash fluctuations
- Highlights future cash surpluses and deficits SO businesses can make comparisons to identify cash improvements or deterioration
- Can be checked to see if they were correctly forecasting SO businesses can be more accurate to help with planning
WAYS TO IMPROVE CASH FLOW

A business can improve its cash flow by:
- Encouraging customers to pay up front
- Sending prompt invoices
- Chasing late payments from customers
- Selling debts to a factoring company
- Selling assets
- Negotiating supplier trade credit terms
- Better stock management e.g., using just in time stock ordering methods
- Arranging an overdraft facility to allow for negative balances

A business could also seek financial help from others in order to increase its receipts during periods of poor cash flow. This could be in the form of a bank overdraft.

QUICK TEST

1. Explain what is meant by the term cash flow forecast.
2. Explain why cash is so important to a business.
3. What is the difference between cash and profit?
4. Suggest three ways in which a business can improve its cash flow.
SOURCES OF BUSINESS FINANCE

SOURCES OF FINANCE

Sources of finance are where a business can obtain money from. They assist with business start up, with operating costs, e.g. salaries, supplies, electricity bills. Sources of finance help with the expansion costs of a business, e.g. investing in new technologies.

SHORT-TERM FINANCE

Overdraft facility – this is when a bank allows a business to withdraw more money than it has in its account, and pay it back later. This is a quick and convenient solution and interest is only paid on the amount of money borrowed and for the time it is borrowed. However, interest rates can be variable and high, a bank may not let you do this and can withdraw this facility at anytime. Trade credit – this is when a business receives goods from a supplier immediately but agrees to pay for them at a later date. This allows businesses to receive payments from its customers before paying suppliers, removing the need to raise its own finance. However, not all suppliers offer trade credit, they may charge higher prices. Some new businesses may not be offered trade credit until financial trust is gained.

LONG-TERM FINANCE

These tend to be for larger amounts of money needed for longer periods of time: PERSONAL SAVINGS – owner’s money. Quick and easy to obtain, no interest. BUT risk in using and losing own money. RETAINED PROFITS – profit from previous trading years. Quick and easy to obtain, no interest. BUT Might not have any retained profit. VENTURE CAPITAL – experienced businesses with large capital offer money to invest. Large capital sums, no interest, risk sits with investor, brings business advice and experience. BUT, Loss of control of business decisions, profit shared, may conflict with existing shareholders. SHARE CAPITAL – owner sells shares in business. No interest or repayment. Private limited companies retain control by selling to family and friends. Public limited companies benefit from quick way to raise capital BUT profit shared, loss of ownership, finances made public. BANK LOAN – sum of money lent by bank to repay in monthly instalments. Keep control, don’t need to share profits, fixed loan repayments, so interest fixed. BUT takes time to arrange. Interest is charged. Repayments must be made on time. Collateral required (something valuable you have to give up to guarantee loan if you can’t repay e.g. your house). CROWD FUNDING – online appeal to attract multiple investors to put small amounts in. Risk is shared, no interest, wide numbers can invest. Good promotion and testing idea. Does not need to be repaid. BUT finance retuned if target not reached. Reputation suffers. Business idea copied. Profits shared. SALE OF ASSETS – when a business sells an item of value. No interest, easy and convenient, creates space. BUT may not get full market price, regret selling in future.
1.3.1 Business aims and objectives

1 Explain one possible non-financial aim an entrepreneur may have when starting a small business. (3)

2 Which one of the following is a definition of market share? (1)

Select one answer.

A Market research that can be collected and analysed
B The proportion of sales in a market made by one business
C The total amount of money from business sales
D A group of people who discuss their views on a product

3 Which one of the following is an example of a non-financial objective for an entrepreneur starting a new business? Select one answer: (1)

A Survival
B Profit
C Market share
D Independence
1.3.2 Business revenues, costs and profits

The Table contains information about a small business for one month. The business sold 340 units in this month.

<table>
<thead>
<tr>
<th>Fixed cost</th>
<th>£3 600</th>
</tr>
</thead>
<tbody>
<tr>
<td>Variable costs (per unit)</td>
<td>£9</td>
</tr>
</tbody>
</table>

4 Using the information provided, calculate the total costs for one month. You are advised to show your workings.
The chart shows information about the financial performance of a business from January to March.

5 Using the information provided, calculate the total profit for the period January to March. You are advised to show your workings. (2)
**Last Course Patisserie Ltd** is a small private limited company based in Devon which produces hand-made desserts and puddings. The business was established in 1986. Its owners previously worked in the food industry but felt they could offer better value for money to customers. All of the desserts are made fresh to order which has provided *Last Course Patisserie* with a reputation for being flexible when meeting customer needs.

Getting the best ingredients for the desserts is a vital part of the business. *Last Course Patisserie* found excellent suppliers of free range eggs and dairy products close to its business location. This means all ingredients could be delivered quickly when needed.

*Last Course Patisserie* has recently employed a new head chef from Switzerland who has introduced a new range of products to the menu. This has proved to be very popular with customers and the business now struggles to keep up with demand. *Last Course Patisserie* is receiving increased orders for desserts but, due to the size of its business premises, struggles to meet this increase in demand. The owners have decided that it is the right time for *Last Course Patisserie* to expand and possibly relocate to new premises.

(Source adapted from: http://devondesserts.co.uk/; photo: © 2009-2018. Last Course Patisserie Ltd.)

*Last Course Patisserie* has the following financial information for the month of April.

<table>
<thead>
<tr>
<th></th>
<th>April</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raw materials for each dessert</td>
<td>£0.50</td>
</tr>
<tr>
<td>Packaging for each dessert</td>
<td>£0.20</td>
</tr>
<tr>
<td>Fixed costs</td>
<td>£2,730</td>
</tr>
<tr>
<td>Selling price for each dessert</td>
<td>£2.00</td>
</tr>
</tbody>
</table>

6 a Using the information provided, calculate the level of output required to breakeven in April. You are advised to show your workings.
In May suppliers increased the cost of raw materials by 4%.

(b) Using the information provided, calculate the variable cost per dessert following the increase in the cost of raw materials.

(2)

7 Which two of the following are examples of variable costs?

Select two answers.

A Advertising  
B Insurance  
C Packaging  
D Raw materials  
E Rent

(2)
8 Which one of the following is an example of a cash outflow for a small business? Select one answer.

A Bank loan
B Personal savings
C Raw materials
D Receipts

9 Discuss the importance of cash to the survival of a small business.
The Table contains information about cash payments of a small business in one month. The business sold 200 units in this month. All customers paid in cash.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Selling price</td>
<td>£15</td>
</tr>
<tr>
<td>Rent</td>
<td>£500</td>
</tr>
<tr>
<td>Wages</td>
<td>£1 000</td>
</tr>
<tr>
<td>Advertising</td>
<td>£150</td>
</tr>
</tbody>
</table>

10 Using the provided, calculate the net cash flow for this month. You are advised to show your workings. 

(2)
On Your Bike is a family owned business that first opened in London in 1983. Its customers include children buying their first bikes and scooters, through to experienced enthusiasts in road cycling and mountain biking.

The business offers a wide range of bikes, many imported from abroad. These include high quality brands such as Brompton, Cannondale and Ridgeback. It also stocks a wide range of clothing and helmets including brands such as Endura and Altura.

On Your Bike has large workshop facilities in its shop where qualified mechanics maintain and repair all makes of bike. All mechanics go on regular training courses to ensure they keep their skills and knowledge up to date with the latest cycling technology. This allows On Your Bike to offer exceptional customer service and advice.

The cycling market has grown over recent years. Market research has shown that an increasing number of tourists like to rent bikes when on holiday. In response to this, On Your Bike operates one of the largest bike rental services in London. Bikes can be hired by the day or week with a choice including road and electric bikes.

This is customer review from a comparison website:

![Customer Review]

**11 Outline one reason why cash would be important to On Your Bike.**

(2)
12 Which one of the following is a short-term source of finance? Select one answer.

A Retained profit
B Share capital
C Trade credit
D Venture capital

14 Explain one advantage to a small business of using trade credit as a source of finance.
Aphrodite is a clothes shop that was formed in 1994 by two brothers, Andrew and Duncan McKenzie. They opened the shop because they had a lifelong enthusiasm for new fashion.

Andrew and Duncan visit Paris, Milan and London each year to buy their stock. They aim to buy well-known brands, such as Stone Island and Hugo Boss, and to also stock clothes from new designers. This range of stock helps provide them with an advantage over their competition.

Customer service has always been an important part of Aphrodite’s success. A polite and friendly attitude greets all customers on arrival at the shop. In 2007 the business launched its website, which sells its range of clothing using e-commerce. The owners looked to maintain existing high standards of service for customers using their website.

A new opportunity was created when the shop premises next to Aphrodite became available to buy. Andrew and Duncan are considering buying the shop in order to convert the two shops into one large premises. They have calculated that this will cost them £250 000 but are undecided on the best way to finance this. Figure 2 shows information about interest rates that might help them when making their decision.

(Source: adapted from https://www.aphrodite1994.com/about-us and interview with owner 9/10/2017; photo: © flicker/Shutterstock)

![UK Interest Rate 2008 to 2016](image)

Figure 2

To pay for the conversion of the premises, Aphrodite is considering two options:

Option 1: obtaining a bank loan
Option 2: crowd funding.

13 Justify which one of these two options Aphrodite should choose. (9)
To pay for the conversion of the premises, *Aphrodite* is considering two options:

Option 1: obtaining a bank loan  
Option 2: crowd funding.

13 Justify which one of these two options *Aphrodite* should choose. (9)