1.3 Putting the Business Idea Into Practice

When Blake Mykoskie founded Tom's shoes in 2006, one of his key objectives was to support children in the developing world. For every pair he sold, the company donated a pair to charity.

1.3.1 Aims and Objectives

1- What are aims and objectives?

- Aims are long term goals
- Objectives are short term targets- usually linked to the aims.
- Objectives are usually SMART: Specific, Measurable, Achievable, Realistic, Timed.

2- Why have aims and objectives?

- Gives employees a clear sense of purpose
- Allows the owner to monitor and measure progress
- Provide a focus for decision making- decisions should help the business to achieve their objectives.

3- Why do objectives differ between businesses?

- Different owners have different values.
- Objectives change as the business grows.

4-**Financial vs non-financial objectives:**

- **Financial: profits, sales growth, costs**
- **Non financial: social, personal (challenges, satisfaction)**

Despite being one of the fastest growing car brands, Tesla has only recently started to make a profit due to their huge ($billions) fixed costs on research and development and their gigafactories in the USA and Europe

1.3.2 Business Revenues, Costs and Profits

1- **Revenue**

- This is the income generated from sales
- Revenue = Price x quantity sold
- It can be difficult to predict price if competition means you have to change your prices frequently
- It can be difficult to predict quantity sold if bad press or external events (Coronavirus) cause a sudden slump in sales.

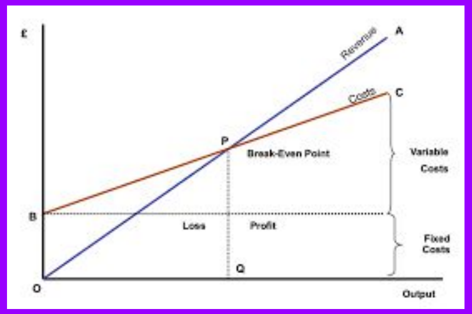
2- **Costs**

- Costs are what the business pay to operate their business.
- Fixed costs have to be paid regardless of how many items are sold. Examples of fixed costs include: rent, salaries, insurance.
- Variable costs increase in line with output: the more you sell, the higher your variable costs are. Examples include: packaging and raw materials.
- To calculate total costs, you first need to work out total variable costs: Total Variable costs = Variable cost per unit x Units produced.
- Total costs + Total variable costs + Fixed costs

3- **Profits**

- Profit is the difference between revenue and costs
- Businesses need to make a profit in the long term to be able to invest in ad grow their business
- Profit = Revenue -Costs

1.3 Putting the Business Idea Into Practice



This is a breakeven chart. It assumes you will charge the same price for every unit sold- is this realistic?

Thomas Cook was one of the UK's biggest and most established travel agents. It went into administration in 2019 after it was unable to generate enough cash to service growing debts and a large portfolio of aircraft and hotels.

1.3.3 Breakeven

1- What is break even and why do businesses need to know about it?

- The break even point is the point at which a business' revenue covers their costs.
- Calculating the break even point tells a business how many items they will need to sell at a given price before they can begin to make a profit.
- If the breakeven point is too high, a business considering launching a new product may decide it isn't viable (because it won't be profitable given the number of sales they predict)

2- **Break even charts**

- When drawing a breakeven diagram, start with fixed costs (this will be a horizontal line- it is the same no matter how many items are produced)
- The breakeven point is where **total costs = total revenue**
- Before the break even point (to the left of the point) the business is making a **loss**
- Each item they sell makes a contribution (price-variable cost) towards reaching breakeven.
- Beyond the break even point the business is making a **profit.**

3-**Calculating break-even**

- Break even = Fixed costs/ (price-variable costs per unit)
- The answer should be in **units** e.g. Breakeven is 10 boxes of/ 20 customers

4-**Margin of Safety**

- The margin of safety is the amount **above** breakeven that a business is selling - the bigger this number is, the better!
- Margin of safety = Sales (in units) - Break even point

1.3.4 The Importance of Cash

1- **Why do businesses need cash**?

- Paying suppliers- so you have stock to sell
- Paying staff
- Paying overheads: rent, lighting, gas, water- failure to do this could result in services being turned off and the landlord kicking you out.

2-**When do businesses experience cash flow problems**?

- When starting up - sales are likely to be low but a lot of money will be spent into buying equipment, hiring staff ad promoting the business.
- When growing rapidly - If you have large orders to fill/ move to a bigger premises it can take time for the cash inflows to balance out the case outflows.

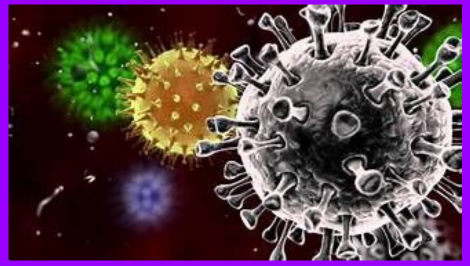
3- **How can businesses manage cash flow problems?**

- Get credit- ask suppliers if you can pay later (trade credit) or get an overdraft.
- Cut unnecessary costs
- Chase up payments from customers

4- How is cash different to profit?

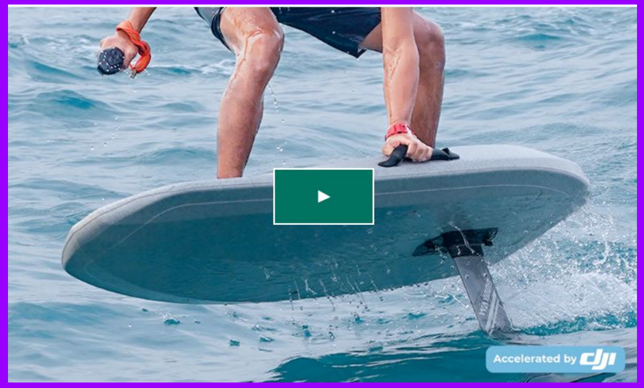
- Cash is needed for day to day operations - without cash a business will quickly become **insolvent.**
- Businesses can survive in the short term without making a profit. Profit is needed in the long term to make running it worthwhile for the owners.

1.3 Putting the Business Idea Into Practice



No business in the UK could have predicted the 3 month lock down in 2020. This has had serious consequences for their cash flow.

Following the financial crisis in 2008, banks are very cautious about who they lend to This has lead to a lot of start up businesses turning to crowdfunding sites like Kickstarter to Get their start up capital.
This hydrofoil board has received over £1 million in pledges.



1.3.5 Cash Flow Forecasts

1- What is cash flow?

- Cash flow is the difference between cash inflows (receipts) and cash outflows (payments).
- For a business to survive, they need to predict and manage cash flow problems to ensure they are able to pay for the running costs associated with the business.

2- What is a cash flow forecast?

- A cash flow forecast is a prediction of future cash flows.
- It looks at what is likely to happen to a business' bank balance over the coming year.

£'000	Jan	Feb	Mar	Apr	May	Jun
Cash at start of month	25	20	15	5	10	20
Cash inflows	20	25	20	15	20	25
Cash outflows	25	30	30	10	10	20
Net cash flow	-5	-5	-10	5	10	5
Cash at end of month	20	15	5	10	20	25

Net cash flow = Cash in- Cash out

Cash at end of month(closing balance) = Cash at start of month + net cash flow

3- What can affect the accuracy of a cash flow forecast?

- Is it easy to predict monthly revenues? In a fast moving market it can be difficult.
- Accurately predict when customers will pay - business customers may delay payments (or not pay at all) if they are experiencing problems.
- Under-estimating costs- If it is a new business you might not have an accurate picture of your costs.

1.3.6 Sources of Finance for Small Businesses

1- Short term vs Long term finance

- Short term finance is finance that is required for less than a year. A business might need finance in the short term to: get through periods of bad cash flow, provide cash to cope with a sudden rush of orders
- Long term finance is required for longer than a year. A business might need finance for: start up capital, buying fixed assets like buildings or machinery, getting capital for expansion.

2- Questions to ask when choosing a source of finance

- Is it secure? Bank overdrafts can be cancelled at any moment.
- Is it expensive? Loans may come with high rates of interest.
- Will it raise enough?

3- Long term sources of finance

- **Personal savings -** don't need to be repaid but may be limited.
- **Share capital**- doesn't need to be repaid. However, if shares are sold on the stock exchange there is a risk of takeover.
- **Loans**- If the business doesn't keep up repayments the bank can repossess their property. Fixed interest loans make it easy to plan cash flow.
- **Venture capital**- A combination of share and loan capital. The venture capital firm will take a stake in the business. Will be more likely to invest in young and risky businesses.
- **Retained profit**- Reinvesting product from previous years.

4- Short term source of finance

- **Bank overdraft**- Flexible loans up to a limit. High interest.
- **Trade credit**- An agreement with suppliers to pay them later.

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