DOES THE SOLE TRADER USE HIS / HER FINANCIAL RESOURCES EFFICIENTLY AND HOW DOES HE / SHE REMAIN SUCCESSFUL?

Business studies coursework - Mrs Joy Parkinson the sole trader.

In 1987 Joy Parkinson, a business studies teacher and avid gardener, was approached by a large retailer and asked whether she would be interested in growing heathers with the intent of selling them on in a wholesale capacity. On that day Joy Parkinson went into business as a sole trader.

A sole trader is any business owned and controlled by one person, although they may employ workers.

The advantages are:

- **The firms are usually small and easy to set up.**
- **Generally, only a small amount of capital needs to be invested.**
- **The wage bill is usually low as there are few/ no employees.**
- **The owner has incentive to work hard as he can keep the profits.**
- **Other than the Tax Office the owner enjoys complete secrecy.**

The disadvantages are:

- **The owner has no one to share responsibility.**
- **Sole traders often work long hours: few holidays or days off ill.**
- **Personal finances limit development of the business.**
- **Owners are personally liable for the firm's debts – *unlimited liability*.**

At that time, due to a fashion trend, there was a large demand for heathers; everyone wanted a garden, but with little knowledge and less time, low maintenance ground cover plants were the customer's ideal. The demand was so high that retailers were unable to supply enough heathers to quench the demand and were forced to look beyond their usual suppliers. Joy's husband, a professional horticulturalist, already had a large country garden featuring many types of heathers; this was what initially attracted the retailer and formed the basis for the new enterprise.

As a wholesaler supplying the retail trade there was no uncertainty of market. All plants produced were to fulfil the quota set by the retailer, there was no surplus and bills were paid when the batch was produced rather than when they were sold.

Aims of a business

- **Make a profit**
- **Allow your business to grow**
- **Enable your business to survive**
- **Provide a service**

Joy's sole aim at this time was to make a profit, her market was guaranteed.

Unfortunately, as with every other fashion trend, the demand for heathers started to decrease leaving Joy with a difficult decision to make: quit the business or diversify! After considering her financial position she decided to change, from being a wholesaler selling only to the retailers, to being a wholesaler selling directly to the public. This meant extending her range of products to include perennials. Mrs Joy Parkinson became a retailer competing with the companies she used to supply.

Firms need short-term finance to start up a business or to cover day-to-day running costs. This is referred to as **start up capital** and is repaid over a short period. As the business continues it may need to raise further capital to purchase fixed assets such as machinery and premises, this is long-term capital and is repaid over a number of years. Sources of finance can be found within or outside the company.

Internal sources are

- Retaining profits.
- Reducing stock levels.
- Selling assets.

External sources are

- Borrow from family.
- Bank loan.
- Government grant.
- Leasing premises or equipment.

Internal sources of finance are usually a cheaper way to raise working capital but a sole trader may be able to borrow from family or friends without paying interest. Loans from a bank or building society can be expensive and monthly repayments can be a problem especially for a business that makes seasonal profits.

When the retailer made the initial approach Joy was employed by the NEELB in a part time capacity so she was able to retain her salaried position. She used the joint savings of herself and her husband as her initial capital and added a percentage of her monthly salary as it was received. Joy decided not to borrow from the bank as interest payments would weaken her financial position, and with both her and her husband in steady employment she considered that it was unnecessary. An application to LEDU for a grant was turned down but two regular salaries ensured that her cash flow was excellent and all current liabilities could be handled quickly.

Businesses may have a variety of different **aims** but the over-riding one is that of **survival**. In order to survive the business may attempt to grow. If the business can grow there are certain advantages it may acquire such as increased sales, increased profits, security and economies of scale. The business can grow through internal growth, the ploughing back of profits, or it can attempt to increase sales by changing the marketing mix. Marketing is the management process responsible for identifying, anticipating and satisfying customer’s needs profitably. If the market is not properly researched and a firm takes on new premises and/or staff in anticipation of increased sales, which fail to materialise, a small profit-making firm can find itself incurring substantial debts. A sole trader, with unlimited liability, needs to be especially careful before increasing liabilities.

When Joy was trading as a wholesaler she was making a considerable profit; selling 40 000 heathers @ 40p each, using approximately 50% mark up, but she was well aware that the retailers were selling on with a 200% mark up. When the decline in demand forced her to open her own shop at her family home she gave up her job with NEELB and hired two part time employees to help her care for the plants. She was aware that the volume of her trade would decrease but hoped to compensate by cutting herself in on some of the profits formerly enjoyed by the retailers. During the summer months her sales revenue was soaring but during the winter she was losing a lot of money as the fixed costs exceeded her winter profits, she couldn't even break even! The accounts showed that the business was not working to its full potential; all of the summer months' profits (and some of the capital) were consumed during the winter months keeping the business afloat.

The aim of businesses in the private sector is to make a profit. Profit is important in three ways. It:

- Rewards the owners of the business who have taken the risk of starting the business.
- Provides cash to pay debts.
- Is a source of cash for future expansion.

A firm produces accounts, called a balance sheet, to calculate its assets and liabilities. The purpose of the Trading and Profit and Loss account is to calculate and show the gross and net profits. If the accounts show that the firm is breaking even or running at a loss, efficiency can be improved in a number of ways.

- Improving staff efficiency by introducing monetary and non-monetary rewards.
- Increasing cash flow.
- Specialisation.
- Making use of interest free credit / delay payments to suppliers.
- Pruning staff.
- Making use of trade and cash discounts.
- Market research.
- Advertising.
- Expanding to increase market share.

Joy's employees are both over 18 years old so minimum wage has to be paid. If she were to employ two workers under 18 (15-17 years old) minimum wage would not have to be paid and a saving of perhaps £1.20 per hour could be made. Nor does she take advantage of her expenditure: she does not get cash or trade discount and has a short repayment time from her creditors.

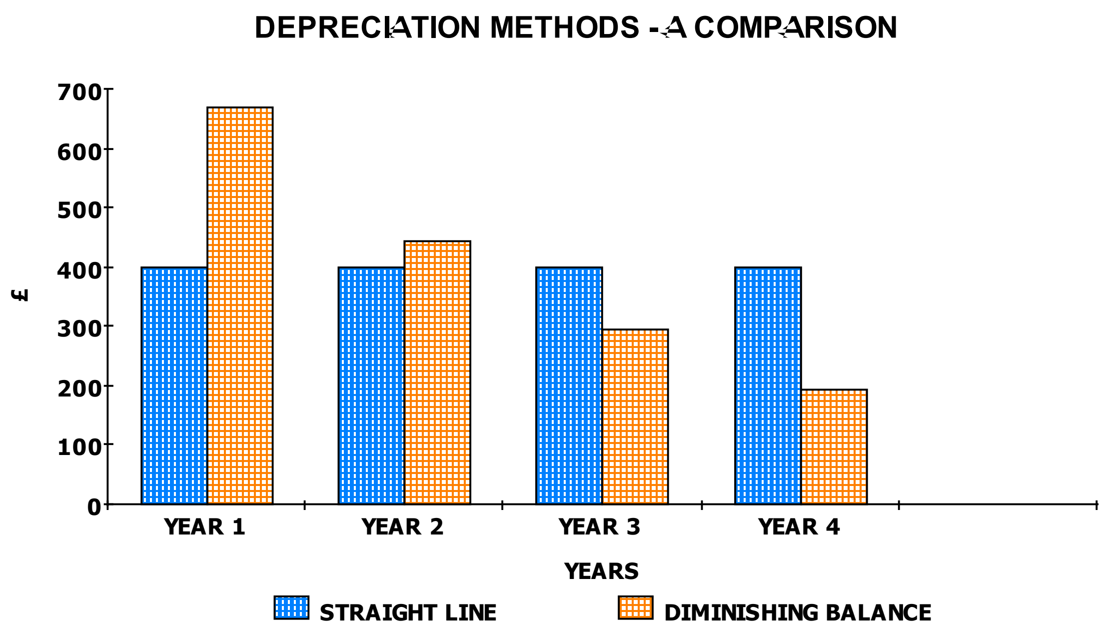
Joy has few fixed assets: her business car and trailer (used for transporting plants from the wholesaler to her then from her to the customer), the fixtures and fittings (i.e. shelves) and of course her premises. Joy has decided to depreciate her fixed assets using the reducing balance method, this means that the value of her assets will depreciate by the same percentage each year:

STRAIGHT LINE METHOD

YEAR	ORIGINAL COST	DEPRECIATION FOR YEAR	DEPRECIATION TO DATE	NET BOOK VALUE
1	2000	400	400	1600
2	2000	400	800	1200
3	2000	400	1200	800
4	2000	400	1600	400

DIMINISHING BALANCE

YEAR	ORIGINAL COST	DEPRECIATION FOR YEAR	DEPRECIATION TO DATE	NET BOOK VALUE
1	2000	667	667	1333
2	2000	444	1111	889
3	2000	296	1407	593
4	2000	193	1600	400



Depreciation is a way of measuring the amount of the fall in value of fixed assets over a period of time.

Joy has decided to depreciate her assets (by 20% each year) using the diminishing balance method; this means that there is a loss of 20% of the assets value from year to year. Depreciation is shown as a loss in the profit and loss account. The diminishing balance method is usually reserved for the depreciation of assets (i.e. cars) that lose their value in uneven amounts, the majority of their cost “on the drive home”. Joy has decided to depreciate all of her assets using this method for the sake of simplicity.

Mrs Parkinson has a perishable stock that needs a quick stock turnover and so accurate records of her plants need to be kept. As Mrs Parkinson is a sole trader with little capital, computerised stocktaking is not available so basic pen and paper records are kept, this is a problem as this can lead to errors in stock levels and Joy cannot quickly tell what plants she has for sale so customers are lost.

Mrs Parkinson does not allow her customers to purchase goods on credit. This is bad business practice because it limits the amounts customers can spend and prevents impulse buying. It would be worth her while to make this facility available.

Net profit percentages are calculated as they reflect how successful the business has been in profitability terms. Management analyse these percentages in order to make comparisons and decide on future plans and objectives. If the Gross Profit or Net Profit percentages have fallen substantially on previous years then remedial action must be taken to improve on next year. The net profit % is most important as it reflects how successful the business has been in profitability terms. These two percentages can be calculated as follows:

$$\frac{\text{Net profits/Gross profits}}{\text{Turnover}} \times \frac{100}{1} = \text{Net/Gross Profit Percentage}$$

Mrs Parkinson was unable to give us any exact figures about her finance but she did give us her working capital ratio 0.7: 1. Working capital is a very important term on the balance sheet. Working capital is the difference between current assets (i.e. stock, debtors and cash) and current liabilities (i.e. creditors and bank overdraft. No business can survive without working capital. It is used to pay short – term debts. If these debts cannot be paid because the business does not have enough working capital, the creditors could force the business to stop trading. It is calculated by the formula:

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

Liquidity is the ability of a business to pay back its short–term debts, it is calculated by:

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

Mrs Parkinson's ability to pay off short term unexpected costs was tested when, on her land, a water pipe burst wasting £750 pounds worth of water. The water board charged Joy this extra cost and she had to pay it back over 3 months because if she had been forced to repay it immediately it would have crippled her business. This incident showed Mrs Parkinson that her liquidity needed to be improved.

Information like this could be very useful to Joy Parkinson and other interested parties (i.e. the bank, potential investors and creditors) as it can show whether or not the business is able to pay back a loan (bank), able to pay its debts (creditors) and whether or not it is wise to invest in the business (investors).

Mrs Parkinson's business has strengths and weaknesses; only after comparing the two can a conclusion be made on her business,

Strengths

- No outstanding debts
- Overdraft facility available
- No loans

Weaknesses

- Sole trader
- Labour intensive
- Strong competition

An idea that Mrs Parkinson should consider is the strategy of diversifying further and taking part in a conglomerate merger. If Mrs Parkinson opened up a coffee shop beside her nursery she could increase her market and more importantly her profits. Mrs Parkinson has a huge garden that she has filled with the plants she has on sale (so customers can see how large plants grow etc.) that receives many guests each year. When people are out shopping they often get thirsty and tired, so a coffee shop next to the garden centre could do very good business.

In order for Mrs Parkinson to diversify she would need to raise a lot of capital that would mean a bank loan, which she would like to avoid if possible, but I believe that for Mrs Parkinson to improve her financial position she needs to conquer her major weakness, her being a sole trader. I believe if she can find an investor/partner to increase her capital she can increase her financial position dramatically. Partners have the advantage of sharing of the responsibility, this allows for specialisation and problems with illnesses are minimized. This new partnership could allow some money to be set aside for some market research which is needed if Joy is to satisfy the customers needs, and in the end get back to making a profit again.