Unit 3 – Investigating Financial Control

I have recently completed my BTEC First Diploma Business and have been employed by Pedro, who owns and runs a hot dog van. He has asked me to investigate his finances; I will be creating a break-even chart for his business.

A) Three types of costs to businesses are start-up costs, fixed costs and variable costs.

Before a business is set-up, the business will need to buy various items such as building and equipment these are called start-up costs, these costs which happens before the business can begin. These costs also occur when a business expands or decides to star a new venture.

Fixed costs are costs which usually occur when the business has begun; these costs remain the same for a period of time and do not vary on output. This means that the business needs to pay the bills whether it sold 100 units or 0 units. Fixed costs are also called indirect costs; these costs include rent and rates.

Variable costs are costs which occur once the business has been set-up. This costs varies on output and is also called direct costs, an example of this cost are the amount of hot dogs vendor requires this depends on the amount it sells.

Revenue is the amount of money received from all of the businesses activities.
The main sources of income for most businesses are its sales which include money received from its customers who buy its products or services. Business may also sell its items it no longer needs to other businesses.
Another source of income for a business is leasing which may include leasing a part of the building to another company; another is leasing equipment to other businesses.
Businesses can earn interest from the banks on an interest bearing account.

The importance of costs and revenue to profit are that costs have to be kept to a minimal and revenue high to create maximum profit.
To find out the profitability of the business you will need to calculate the total costs of the business this includes the total fixed costs and the total variable costs. Then calculate the total revenue of the business.
To find out if the business is making a loss or a profit you will need to find out the gross profit and the net profit.

The gross profit is the money left from sales income once the costs of materials are taken away.
The net profit is the gross profit minus the operating costs; the operating costs are the variable costs plus the fixed costs.

There are two ways of maximising profits, these are to increase sales or reduce operating costs.
There are a number of ways to increase sales income these include increasing prices, reduce prices to increase sales, increase advertising, sell new products to existing customers and increase scale of business.
There are a number of ways to reduce the operating costs of a business these include staff wages, property rental, cheaper suppliers and less usage.

The importance of profit to a business is to pay its owner/s a wage. Profits can also be kept in the bank to use as reserves for a later time or in case of emergencies. Profits can also be used to expand the business. They can update or upgrade equipment to improve efficiency or repay any debts.

B) A break-even chart can predict whether the business is making a profit, loss or breaking even, break-even is when a business does not make a profit or a loss.

A break-even graph can be drawn to see the business profitability. This can be done by creating a graph with the y axis cost and revenue and the x axis units sold. The graph should contain a fixed cost line which is a horizontal line, total costs line which is the variable costs plus the fixed costs and a total revenue line which is the units sold times the selling price.
The break-even point in the graph is the point where the total cost line and the total revenue line intersect. This can predicted the amount of units needed to sell to break-even and the amount of sales revenue; this can also predict the profit margins.

A beak-even formula can also predict the break-even point; the number of sales required to break-even can be calculated by dividing the fixed costs by the variable costs minus the selling price.
C) For examples if you sold your hot dog at £2 with a variable cost of 50p and fixed costs of £1250 per month which include a salary and rent. So your break-even formula would go as follows:

£1250 / (£2.00 - £0.50) = units needed to break-even
(Fixed cost) (Selling price – variable cost)

So to calculate the formula you will need to minus the selling price from the variable price which equals £1.50, then you will need to divide into the fixed costs (£1250) by £1.50 which equals 834, this means the business will need to sell 834 units to break-even.

D) A business can check its profitable activity level by using a break-even formula as they can predicted how many units it needs to sell to break-even. It can also help owners answer key questions and help business make decisions. For examples if a business wants to expand using the break-even formula it can help the owner decide whether they can afford it and how long it will take till the business see a return in their investment.