5 Why a business needs finance – Part 1

Name: _____ Class: _____ Date: _____

Vocabulary

Write each word three times.

English	**Write it 3 times** (English)		
Business finance			
capital expenditure			
fixed assets			
revenue expenditure			
internal sources			
external sources			
retained profit			
share capital			
loan			
overdraft			
profit			
cash			

Recall

Starting and running a business costs money. Bring this with you:

- You pay for things with money every day; a business does too, but on a much larger

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scale.
- A business that runs out of money has to stop.

At AS we study where a business gets its money (**finance**) and how it manages cash.

New ideas

1 Why finance is needed

Business finance is the money a firm needs to start, run and grow. Spending falls into two kinds:

- **capital expenditure** – money spent on **fixed assets** that last a long time (machines, vehicles, buildings);
- **revenue expenditure** – money spent on day-to-day running (wages, rent, raw materials).

capital expenditure
fixed assets that last
(machines, vehicles, buildings)

revenue expenditure
day-to-day running
(wages, rent, materials)

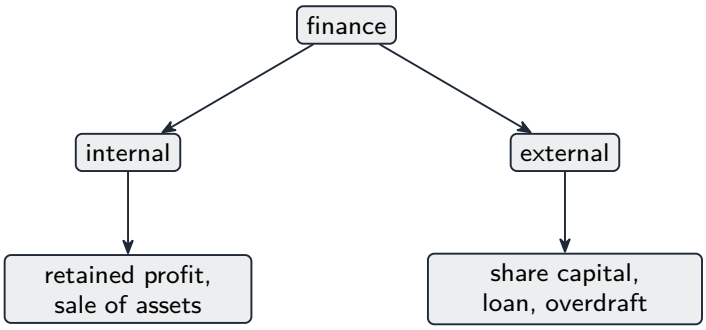
Micro-check. Is buying a delivery van capital or revenue expenditure? [1]

2 Sources of finance

Finance comes from **inside** the business (**internal sources**) or from **outside** (**external sources**):

- internal: **retained profit** (profit kept in the business), or selling assets the firm no longer needs;
- external: **share capital** (money from selling shares), a **loan**, or an **overdraft** (the bank lets the account go below zero for a short time).

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Micro-check. Is a bank loan an internal or an external source? [1]

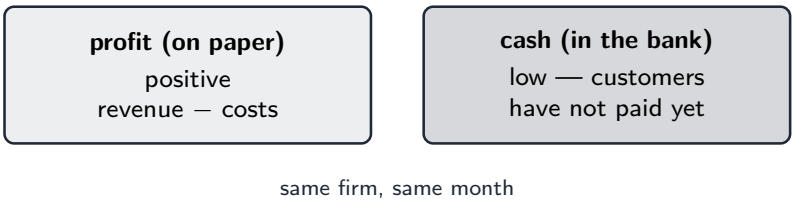
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3 Cash is not the same as profit

This is a key idea:

- **profit** is what is left when total costs are taken from total revenue over a period;
- **cash** is the money the firm actually has **right now** to spend.

A firm can be **profitable** but still run out of cash – for example, if it has sold goods but customers have not paid yet. Many firms fail not from low profit, but from running out of cash.



Micro-check. Can a profitable business still run out of cash? [1]

Watch out: *cash is not the same as profit* – a profitable firm can still run out of cash (e.g. customers have not paid yet). Capital expenditure buys long-lasting assets; revenue expenditure pays day-to-day costs.

Practice

5.1 State which is **capital** and which is **revenue** expenditure: (a) buying a new factory; (b) paying this month's wages. [2]

5.2 State whether each source is **internal** or **external**: (a) retained profit, (b) a bank loan, (c) selling shares. [3]

5.3 Explain how a business can be profitable yet still run out of cash. [2]

5.4 Give **one** internal and **one** external source of finance. [2]

5.5 State what an **overdraft** lets a business do. [1]

5.6 Challenge. A firm makes a healthy profit but its bank account is empty because it sells on 60-day credit. Suggest **one** way it could improve its cash without lowering its profit. [2]