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GCSE Business Studies

What is profit?

Finance is the money available to spend on business needs.

Right from the moment someone thinks of a business idea, there needs to be cash. As the business grows there are inevitably greater calls for more money to finance expansion. The day to day running of the business also needs money.

The main reasons a business needs finance are to:

▶ **Start a business**

Depending on the type of business, it will need to finance the purchase of assets, materials and employing people. There will also need to be money to cover the running costs. It may be some time before the business generates enough cash from sales to pay for these costs. [Link to cash flow forecasting.](#)

▶ **Finance expansions to production capacity**

As a business grows, it needs higher capacity and new technology to cut unit costs and keep up with competitors. New technology can be relatively expensive to the business and is seen as a **long term** investment, because the costs will outweigh the money saved or generated for a considerable period of time. And remember new technology is not just dealing with computer systems, but also new machinery and tools to perform processes quicker, more efficiently and with greater quality.

▶ **To develop and market new products**

In fast moving markets, where competitors are constantly updating their products, a business needs to spend money on developing and marketing new products e.g. to do marketing research and test new products in "pilot" markets. These costs are not normally covered by sales of the products for some time (if at all), so money needs to be raised to pay for the research.

▶ **To enter new markets**

When a business seeks to expand it may look to sell their products into new markets. These can be new geographical areas to sell to (e.g. export markets) or new types of customers. This costs money in terms of research and marketing e.g. advertising campaigns and setting up retail outlets.

▶ **Take-over or acquisition**

When a business buys another business, it will need to find money to pay for the acquisition (acquisitions involve significant investment). This money will be used to pay owners of the business which is being bought.

▶ **Moving to new premises**

Finance is needed to pay for simple expenses such as the cost of renting of removal vans, through to relocation packages for employees and the installation of machinery.

▶ **To pay for the day to day running of business**

A business has many calls on its cash on a day to day basis, from paying a supplier for raw materials, paying the wages through to buying a new printer cartridge.

Why businesses need finance

A business needs to assess the different types of finance based on the following criteria:

- ▶ **Amount of money required** – a large amount of money is not available through some sources and the other sources of finance may not offer enough flexibility for a smaller amount.
- ▶ **How quickly the money is needed** – the longer a business can spend trying to raise the money, normally the cheaper it is. However it may need the money very quickly (say if had to pay a big wage bill which if not paid would mean the factory would close down). The business would then have to accept a higher cost.
- ▶ **The cheapest option available** – the cost of finance is normally measured in terms of the extra money that needs to be paid to secure the initial amount – the typical cost is the interest that has to be paid on the borrowed amount. The cheapest form of money to a business comes from its trading profits.
- ▶ **The amount of risk involved in the reason for the cash** – a project which has less chance of leading to a profit is deemed more risky than one that does. Potential sources of finance (especially external sources) take this into account and may not lend money to higher risk business projects, unless there is some sort of guarantee that their money will be returned.
- ▶ **The length of time of the requirement for finance** - a good entrepreneur will judge whether the finance needed is for a long-term project or short term and therefore decide what type of finance they wish to use.

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