

A293

**Bowton Mountain
Festival 2017**



BMF Ltd

Student Revision Booklet

Name:

Hi Businesspeople,

Here is your complete guide to the A293 case study

Do not be scared of the length of it!! – you do not HAVE to read every line (although you may choose to). The purpose is to support you in answering the questions. The guide includes information on all of the key concepts which you might be examined on

Tasks

- **Highlight key terms as you go**
- **You may want to make spider diagrams of parts that you find difficult**
 - **Answer all of the exam questions**

Ask your parents to sign and return the slip at the back by 1st May 2017

SECTION 1 - INTRODUCTION

The Legal Structure of Bowton Mountain Festival Ltd

Bowton Mountain festive takes place for 3 days every August in a town called Bowton. BMF Ltd is a private limited company. BMF Ltd was set up by a group of outdoor pursuits enthusiasts 20 years ago who each invested £5,000 in shares in the company. Because it is an LTD they cannot sell shares to the general public on the stock market, they can only sell shares to family and friends to raise money.

The Criticism about Drunk and Badly Behaved People

The case study says last year there was criticism of the festival

The costs are

- **Social costs** are the total of all costs from an economic activity they are the private costs and external costs.
- **Private costs** are the costs the business has for taking part in a particular activity. E.g. financial/share holders time
- **External costs** are the costs suffered by a third party ie those not directly involved in the particular e.g. local people

What other external costs might arise from The Festival?

- increased noise and / or traffic congestion both before, during and after The Festival
- increased air pollution from exhaust fumes
- pollution - if waste created from The Festival is not disposed of properly

Bowton Mountain Festival's Customer Base and Influence of Changes in Exchange Rates on the Number of Visitors from Some EU Countries

20% of 2016 Festival attendees came from other European countries

This show BMF Ltd is involved in international trade. It means that the cost of attending The Festival - for people from other European countries - will be affected by changes in the exchange rate - between the pound sterling (£) and the currency of the European countries where these festival goers live. The cost of going to The Festival for people coming from European countries would not just be affected by the price of the Festival ticket, but the cost to travel to and from the UK, and the price of food and accommodation in the UK.

The exchange rate is the price of one currency in relation to another, eg during one particular moment in time £1 may buy 1.3 euros, or 1 euro may buy 76.92 pence. If, for example, 1.4 euros equalled 1 British Pound, but this fell to 1.2 euros equals 1 British pound, then this would make it less expensive for people living in a country within the Eurozone to visit the UK and go to the Bowton Mountain Festival, and this could increase the number of visitors. If, on the other hand 1.2 euros equalled 1 British Pound but this rose to 1.4 euros, then) this would make it more expensive for people living in a country within the Eurozone to visit the UK and to attend the Bowton Mountain Festival, and this could reduce the number of visitors.

The extent to which a change in the exchange rate between the pound sterling and the euro would affect the number of visitors would depend upon:

- the extent of the change between pound sterling and the euro; and
- the number of people who attend The Festival that come from countries within the Eurozone.

The greater the change in the rate of exchange between pound sterling and the euro, and the higher the proportion of Festival attendees that come from the Eurozone, the bigger the impact on the number of visitors attending the Festival and, the bigger the impact on BMF Ltd's ticket sales and total revenue.

60% of 2016 Festival attendees were under 30 years of age

An increase in the number of people within the UK and other European countries who are within this age category could increase the number of people going to the Festival and, revenue for BMF Ltd.

70% of 2016 Festival attendees had incomes above the EU average

Consumer incomes is the money individual consumers earn from working.

Consumer incomes can actually be classed into:

- disposable income - the money left over after compulsory deductions such as tax and national insurance payments have been made.

- discretionary income - the money left over after people's basic necessities eg food, drink, mortgage, clothes, travel to work, etc have been paid.
- Household income – Is the total income of all the members of a household who are 15 years old and older. As the majority of Festival attendees have incomes above the EU average might mean that the type of people who attend The Festival will still attend even if the price of the weekend pass changes

The Theme of the Festival and One of BMF Ltd's Core Values

This is 'Enjoying but protecting the environment and its people',

By showing they are concerned about the environment it could help BMF by:

- help BMF Ltd to attract and keep customers- this would help to maximise ticket sales and revenue for BMF Ltd.
- Allow BMF Ltd to charge a higher price for its Festival tickets and, its Festival T-shirts as people may be willing to pay a higher price for a company with an 'environmentally-friendly' image. This would also help to maximise revenue and increase profit for BMF Ltd.
- make it easier to attract and keep good staff to help run The Festival each year. This would mean it cost less to recruitment new people
- make it easier to attract good guest speakers. This could make the individual events more popular so BMF Ltd could increase the price of tickets which would increase the total revenue for BMF Ltd.
- make it easier to get sponsorship, grants, loans and trade credit (from suppliers). This would make is easier for BMF Ltd to get money it might need.

If the report about the Chinese supplier is true it could damage BMFs reputation as a company that cares about the environment and its people and so it would no longer have these benefits

Section 1, lines 16 to 18 state that 'the theme of The Festival this year is 'Enjoying but protecting the environment and its people', and that 'The protection of the environment is one of the core values of BMF Ltd and it has taken every opportunity in previous festivals to highlight the importance of this'.

Explain **one** advantage to BMF Ltd of having and promoting the protection of the environment as one of its core values.

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Spirit of Adventure - An Independent Shop and the Only Retailer of Outdoor Pursuits Gear in Bowton

Independent shops are usually small, single shops (ie not a chain of shops) that are managed by their owner.

Negatives of being an independant

- Spirit of Adventure is likely to have fewer opportunities for economies of scale so may not be able to be as competitive on price.
- Spirit of Adventure will get the financial support of a larger company and will have less opportunities to raise money so growth may be slower.
- employees may also have less chance for promotion and might not have a pensions scheme as an independent business might not be able to afford one.

Benefits of being independent

- Spirit of Adventure might be able to respond more quickly to changes in local market condition as they don't have to ask anyone above
- Employees might be more committed to the business objectives

- The staff might be more motivated as they can use their own initiative

What is a 'retailer' and what is the significance of the fact that Spirit of Adventure is the only retailer of outdoor pursuits gear in the town?

retailers are businesses that buy goods direct from producers or wholesalers for resale to the public in shops or other retail outlets.

- A market is a place where buyers and sellers (or suppliers) get together to exchange products and services (for money).
- A monopoly market is where only one firm supplies the market ie there is no competition and no close substitutes. They have a lot of power to set prices.
- A competitive market is where there are many buyers and many sellers and each seller is likely to have a small share of the market.. Products are likely to have the same basic functions but there may be) differences in product 'qualities', taste and / or circumstances eg location or reputation. Firms operating in competitive markets have some control over price. Although Spirit of Adventure is the only retailer of outdoor pursuits gear in the town of Bowton people could travel to them or use the internet to get them delivered. Therefore, Spirit of Adventure is unlikely to be able to enjoy the benefits of a true monopolist so can not set prices too high. Also during the festival they have direct competition from specialist retailers who rent stalls on the festival field.

SECTION 2 - REVIEW OF THE BOWTON ECONOMY

Councils generally spend money on the following: Rubbish collection, homelessness, schools, courts etc.

Councils have been cutting spending. This could involve Council job cuts and those losing their jobs would have less income to spend on goods and services, which could result in lower sales and, revenue and profit for local businesses in Bowton. Businesses that sell luxuries like Spirit of Adventure will be affected rather than businesses that sell necessities like medicine and food. As the cut to council expenditure is a national requirement BMF could see ticket sales and revenue falling if people see it as a luxury.

Lower Incomes and Higher Unemployment in Bowton (than the National Average) and Pressure on Council Spending on Welfare Benefits

Unemployment is the number of people in the working population who are unable to find work. People on lower incomes may not be able to afford as many luxuries as people on higher incomes, and unemployed people have less income to spend on goods and services. This reduces demand for goods and services and, thus, reduces sales and revenue for businesses. So they might try and get people from outside Bowton wot come to the festival. High unemployment might have some good point for businesses in Bowton such as:

- easier recruitment - as there should be more people for each vacancy.
- less pressure to increase wages -
- increased staff retention (less people leaving their job)

But for the council there will have to spend more on welfare benefits e.g. jobseekers allowance and housing benefits.

Economic Growth and Rising Incomes in the UK

When an economy has grown this means that the number of goods and services produced during the time period in question has increased. . Along with a period of increased output, there will be falling unemployment (as firms need more labour to increase output) and, as a consequence, rising incomes. Greater income to spend on goods results in greater sales, revenue and profit, and better cash flow for individual businesses. For BMF economic growth and rising incomes may well have resulted in increased ticket sales and increased revenues and profit.

Lower Economic and Income Growth in Other European Countries

Although there has been lower growth there has still been economic growth in the european countries so BMF will still have had higher ticket sales from European people coming to the festival which will have increased revenue and profit.

The Uneven Income Growth in the UK & Europe / Widening Gap between Rich & Poor and Increased Part-time & Zero-hours Contracts

The gap between the rich and the poor is widening because the richer have got richer and the poorer have got poorer. While the number of people going to the festival might not be going up. The customers that can afford to go will have enough money to buy expensive clothing and have more money to spend whilst they are there.

Part-time employment = working less than 35 hours a week. part-time employees have the same rights as full-time employees - for example - to training, holidays, maternity leave .

A zero-hours contract is a legal agreement between an employer and a worker where the employer does not have to provide any guaranteed working hours (so pay). There are no set hours or times and workers on a zero-hours contract do not have the same rights as full or part-time employees although they are entitled to holiday pay and a safe working environment. Zero-hours contracts are used a lot when staffing levels change though the year like hotels.

Having part time and zero hour contracts increases the flexibility of a business to meet changes in demand without spending a lot on labour costs. Some staff might not like zero hour contracts as it can be difficult to arrange childcare and make it difficult to plan.

Increased Economic Output in Bowton and Reduced Unemployment through an Increase in Zero-hours Contracts

Output is the quantity of goods or services produced in a given time by a firm, industry or geographical region (Bowton). There is increased output in Bowton which we can see from reduced accommodation prices and helped to increase tourism to the area.

Increased output would also mean increased tax revenues for the government, which could be used to reduce the government deficit). This is because higher output requires more working hours and, creates jobs. Unemployment has, in fact, been reduced in Bowton, but this has largely been achieved through the use of zero-hours contracts, which may not benefit lower-paid workers.

incomes in Bowton remain below the national average, and unemployment in Bowton is higher than the national average this:

- limits the number of people locally who can afford to buy Spirit of Adventure's expensive outdoor pursuits gear.
- might also limit the number of people locally who can afford to buy a ticket to the Bowton Mountain Festival.

As a result, both businesses (ie Spirit of Adventure and BMF Ltd) may:

- invest significant time and effort in attracting customers from richer areas outside the town of Bowton, in order to generate the level of sales they require to more than cover their costs, and make a decent level of profit.

The Fluctuating Pound Against the Euro - The Potential Effect on Bowton Mountain Festival (and BMF Ltd)

How might a fluctuating pound affect the Bowton Mountain Festival?

- If the value of the British Pound fell in value against the euro then it would cost a potential attendee from a country within the Eurozone less to attend The Festival. This could increase the number of people attending The Festival from countries within the Eurozone
- If, on the other hand, the value of the British pound rose in value it would cost a potential attendee from a country within the Eurozone more to attend The Festival, and this could reduce the number of people attending The Festival from countries within the Eurozone (and reduce BMF Ltd's ticket sales and total revenue

The greater the change in the rate of exchange between pound sterling and the euro, and the higher the proportion of Festival attendees that come from the Eurozone, the bigger the impact on the number of visitors to the Bowton Mountain Festival and the bigger the impact on BMF Ltd's tickets sales and total revenue.

What strategies might BMF Ltd employ in response to a potentially unfavourable change in the exchange rate?

If the value of the pound rose against the Euro BMF Ltd could:

- reduce the price of its tickets to these EU customers – this would reduce profit

- invest more money in promoting The Festival amongst potential customers within the UK, or in other European countries or countries where the rate of exchange has changed in a good way. This could increase business expenses though which could reduce profit.

The Government Deficit and Pressure to Increase Income Tax

The government deficit is the amount by which a government's spending is more than the money it receives. Reducing a government deficit may involve cutting government spending (expenditure) and / or increasing government receipts (revenue), for example, by increasing taxes.

Income tax is a type of direct tax which people pay on what they earn. . If income tax increases, this will lead to less disposable income (the money that is available for consumers to spend. This might lead to:

- People buying less goods.
- Customers trading down and buying cheaper alternatives, unless a business is able to cut costs and / or take lower margins in order to compete on price.

A raise in income tax could:

- Reduce sales and revenues of Spirit of Adventure - as customers cut back on expensive outdoor pursuits gear and / or trade down and buy from retailers that are part of a large national chain, that can sell cheaper due to economies of scale.
- Reduce ticket sales and revenues of BMF Ltd - as people cut back on luxuries, such as attendance at the Bowton Mountain Festival.

The extent of the effect on the Case Study businesses' revenues will depend on the extent and length of the increase in income tax; the bigger the increase and the longer it lasts, the bigger the impact on sales and revenues.

The Supply and Price of Accommodation in Bowton Resulting in Increased Tourism

Increased tourism in the area means that more people from outside Bowton are visiting the area. This is likely to lead to increased demand for, and increased sales of products and services. With more tourists, both BMF Ltd and Spirit of Adventure may have experienced an increase in sales, revenues and overall profit.

Reduced accommodation prices also makes it cheaper for people from outside the town to attend the Bowton Festival for more than one day. This could increase the number of weekend passes BMF Ltd sells, and thus increase revenues and overall profit for BMF Ltd.

A Potential Rise in Interest Rates in the UK

The interest rate is the cost of borrowing and the reward for saving. interest rates are used to control inflation ie the rise in the general level of prices.

Higher interest rates would mean that:

- it costs more to borrow and that mortgage holders have more interest to pay, and less discretionary income ie money to spend on non-essential items.
- consumers are also more likely to save rather than spend - as there is more reward for saving.

In the case of Spirit of Adventure, or BMF Ltd, consumers might be less able and / or willing to spend money on expensive outdoor pursuits gear, or tickets to festival events. In which case, either business could have a fall in demand for the products / tickets it sells and suffer reduced sales and, reduced revenue and overall profit.

Higher interest rates would also increase the costs (business expenses) associated with using an overdraft facility and / or taking out a bank loan, which BMF Ltd is considering using to finance the purchase and selling costs of The Festival T-shirts.

Remember, the extent of the effect will depend on the extent and length of the rise in the interest rate; the bigger the rise and the longer it lasts, the bigger the impact on sales and revenues, and on costs.

What advantages or disadvantages are associated with selling shares?

Advantage to selling shares over loans- You do not need to pay interest payments. Dividend payments are not fixed and do not have to be paid in an unprofitable year.

Disadvantages of selling shares-

- Selling shares in a business dilutes ownership and control and profits.
- It can be a slow and expensive method of raising finance

What can shareholders do if they are dissatisfied with the performance of the company?

Although the value of BMF Ltd’s shares has grown, some of BMF Ltd’s shareholders are not entirely pleased with the performance of the company. This could make it difficult to raise finance in the future from selling further shares through a rights issue to existing shareholders.

The Grant from the Council towards the Costs of the 2017 Festival

How might The Festival help the town?

The Festival attracts visitors to the town who are likely to spend money in local businesses - both on the festival site (if local businesses have stalls at the festival), and off The Festival site, for example in local hotels, bed and breakfasts, pubs, restaurants, shops and petrol stations. This will boost the income of local businesses and create jobs for local people. Anything that creates new jobs / reduces unemployment in the area will, in turn:

- reduce the welfare benefits Bowton Council has to pay to unemployed local people.
- increase the income the government receives from taxes in the form of PAYE and NI on the wages and salaries of people employed to work. Such a grant might, therefore, be ‘self-financing’ for Bowton Council

What are the advantages and disadvantages of this grant for BMF Ltd?

BMF Ltd has asked for the grant so that it can ‘advertise The Festival more than in previous years’. Such a grant could, therefore, help boost ticket sales and, thus, revenues and overall profit made at this year’s Festival, as well as help to secure sponsors (discussed in the following section). Grants also have numerous advantages and disadvantages over other methods of finance.

Advantages

- Unlike loans, grants are interest free and can be a cheap form of finance.
- Unlike loans, grants do not have to be paid back and, therefore, do not raise the debts of the business.
- Unlike shares, there is no dilution of ownership and control (or profits).

Disadvantages:

- The grant will not cover all the costs of running The Festival: BMF Ltd still has to find another £320,000 (£350,000 - £30,000) to cover all the expected total festival costs.
- Applying for the grant could have been time-consuming.

(iii) Explain **one** advantage to BMF Ltd of having a grant from Bowton Council towards the costs of The Festival.

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What other sources of finance might be available to BMF Ltd?

Bank Loans – later

Retained profit

A BMF Ltd has been running for 20 years it is likely it will have kept some profit (cash) to pay towards costs. Retained profit is the easiest, quickest, least costly and least risky way to finance investment, as follows:

- Unlike loans and other external finance, it is available immediately
- Unlike loans there is no interest to pay, and there are no ongoing leasing or rental payments - as with leasing or hire purchase.
- Unlike loans there is no need to provide any security ie collateral in the form of fixed assets, or guarantees - in case loan repayments are not met.
- Unlike shares there is no dilution of ownership and control.

Sponsorship from Outdoor Pursuits Businesses

Sponsorship involves an individual, business or other organisation supporting an individual, group or event, either financially or materially, in exchange for the ability to commercially exploit the association. public exposure of the sponsor's name and / or brand names. This might take the form of the business / brand names and / or logos being displayed prominently

Revenue from the Sale of Tickets

Visitors can buy either of the following:

- A weekend pass, which, for £60 this year gives access to all venues and events.
- Tickets for individual events, which are priced according to popularity of the event.

What is revenue?

Revenue is calculated by multiplying quantity by selling price per unit.

E.g. if BMF Ltd sold 7,000 weekend passes this year, then the revenue generated from the sale of these weekend passes would be £420,000 (7,000 x £60).

This is not be the total revenue BMF Ltd received from ticket sales for this year's Festival, as people may only want to attend a specific event and can purchase a ticket for individual events, instead of a weekend pass.

Total revenue must be more than total costs if the business is to make a profit.

How much more revenue from ticket sales will BMF Ltd need to generate to cover the expected total costs (shown later in Fig. 2) and make a profit?

With the grant of £30,000 from Bowton Council, if BMF Ltd is able to raise the £50,000 expected in sponsorship, it will still need to generate more than £270,000 from ticket sales (£350,000 - £30,000 - £50,000). This equates to 4,500 weekend passes (£270,000 / £60).

What factors could make it difficult for BMF Ltd to achieve the level of ticket sales required to generate sufficient revenue to make a profit?

Over 10,000 people attended The Festival last year so covering the total costs of The Festival and making a decent level of profit does not look as if it will be an issue for BMF Ltd. However, this could prove difficult if:

- income tax and / or interest rates rose significantly in the UK prior to The 2017 Festival - as this would reduce the amount of income people in the UK have available to spend on luxuries, such as attendance at festivals; and / or
- the pound strengthened significantly against currencies in other European countries - as this would make it more expensive for people in other European countries to visit the UK and attend The Festival.

The Expectation that More Visitors Will Attend from the UK

Because:

- The UK has experienced higher economic growth than some European countries, and higher growth in incomes than many European countries.

Remember, with economic growth comes lower unemployment and greater income to spend on goods and services such as luxuries, including attendance at festivals such as the Bowton Mountain Festival.

- Fig.1 also referred to the pound fluctuating against the euro and it may be that the pound is expected to strengthen against the currencies of other European countries, including the euro. This would make it more expensive for people within these countries to visit the UK and attend the Bowton Mountain Festival.
- The increased investment in advertising mentioned in Section 3 of the Case Study (and discussed previously above) - for which BMF Ltd received the £30,000 grant from Bowton Council. Perhaps this has / is being invested in promoting The Festival more amongst potential attendees within the UK, rather than potential attendees in other European countries.

SECTION 4 - FESTIVAL COSTS - 2016 AND 2017

Analysis of Fig. 2 - Actual Festival Costs in 2016 and Expected Festival Costs for 2017 (to BMF Ltd)

What are costs and total cost?

Costs are the money paid by a business to get the resources it requires in order to produce and market its products and / or services.

Total cost is the total cost of producing all output over a period of time eg day, week, month, quarter or year. It is calculated by adding together the total fixed cost and total variable cost (or total direct and indirect cost).

Remember:

Fixed costs are costs that remain the same regardless of the output quantity, ie the number of tickets, or the number of Festival T-shirts BMF Ltd sells. These might include, for example, salaries of managers and insurance required to hold the Bowton Mountain Festival.

Variable costs are costs that change according to output quantity, ie the number of tickets or Festival T-shirts BMF Ltd sells. These would include the cost of T-shirts from suppliers in the case of T-shirts, for example. Once total cost is known a business can work out the average cost of producing or providing a single unit e.g. the cost of meeting the needs and expectations of a single Festival goer, and this information can be used in setting the selling price per unit e.g. the selling price per ticket.

Note: The average cost is calculated by dividing the total cost of producing a certain level of output by the number of units produced (or customers served).

What does Fig. 2 tell us?

Actual Festival Costs 2016

The actual total cost to BMF Ltd for the 2016 Festival was £280,000. The biggest cost was administration. This accounted for 60% of the total cost, which equates to **£168,000** (£280,000 x 0.6). Speaker fees and expenses was the second biggest cost. This accounted for 25% of the total cost, which equates to **£70,000** (£280,000 x 0.25). The cost of the venue accounted for 10% of the total cost, ie **£28,000**. The smallest cost was for film costs. These accounted for just 5% of the total cost, ie **£14,000**.

Expected Festival Costs 2017

The expected total cost to BMF Ltd for the 2017 Festival is £350,000. This is **£70,000** ie 25% higher than the actual total cost for 2016 (£350,000 - £280,000 / £280,000 x 100). The biggest cost is still administration but this is expected to be a smaller proportion of the total cost than in 2016 at 54% instead of 60%. this equates to **£189,000** (£350,000 x 0.54), which is £21,000 ie 12.5% higher than in 2016. Speaker fees and expenses are expected to be a slightly higher proportion of the total cost than in 2016 at 27% instead of 25%. This equates to **£94,500** (£350,000 x 0.27), which is £24,500 ie 35% higher than in 2016. The venue is expected to be a slightly smaller proportion of the total cost than in 2016 at 9% instead of 10%. This equates to **£31,500** (£350,000 x 0.09). This is £3,500 ie 12.5% higher than in 2016. Film costs are expected to be a higher proportion of the total cost than in 2016 at 7% instead of 5%. This equates to **£24,500** (£350,000 x 0.07). This is 10,500 ie 75% higher than in 2016. There were no policing costs in 2016 but these are expected to be 3% of the expected total cost in 2017, which equates to **£10,500** (£350,000 x 0.03). This is likely to have been required as a result of the criticism received last year about the number of people who were drunk and badly behaved on the streets after the nightly Parties.

Are there other costs mentioned in the Case Study that are not evident in these pie charts?

- Administration - may include management salaries and staffing costs.
- The costs of running a festival would include the cost of public liability insurance and the cost to secure utilities and facilities to the Festival Field such as toilets, waste management and electricity - to be able to put on concerts and show films, etc and provide site lighting. Perhaps all these costs have been included under 'venue' costs (besides the cost to hire Bowton Park as the Festival field).

- Advertising was a cost last year (and in previous years) and is also a cost this year.

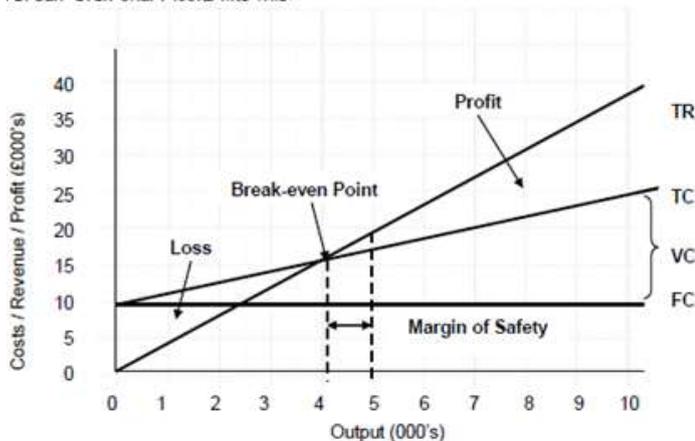
If any of the above costs, or any other costs involved in running The Festival have not been included in the costs shown in these pie charts, then the actual total cost would have been higher than this in 2016, and the expected total cost would be higher than this in 2017. This means that, BMF Ltd might need to sell more tickets to cover total cost and make a profit.

Do we have sufficient information to calculate break-even?

Break-even is the point at which neither a profit nor a loss is made ie when total revenue equals total costs; Break-even level of output is the output in terms of quantity required to be produced and sold to ensure the total revenue received from the output, (if sold), will cover all ie total costs. The break-even level of output can be calculated by using the following equation:

$$\frac{\text{Total Fixed Costs}}{\text{Unit Selling Price} - \text{Unit Variable (Direct) Cost (Unit contribution)}}$$

break-even chart looks like this:



The Use, Benefits and Limitations of Break-even Analysis:

Break-even analysis can help a business to:

- calculate the number of items that need to be sold at a certain price to break-even.
- quickly and easily assess the profitability of a new product and help determine whether the potential reward is worth the risk.
- make decisions about the prices to charge for its product(s) / service(s).
- calculate the volume of sales to reach a target level of profit.
- investigate 'what if' scenarios eg if costs or prices were to change, and enable a business to implement and / or plan for such change.
- make comparisons between specific options (other than changes in selling price) eg new products / markets / locations, and make more informed choices between such options.
- secure loans and other sources of external finance.

Break-even analysis does have its limitations. It assumes:

- that costs can be neatly divided into fixed and variable costs - Some costs have elements of both (semi-variable costs).
- that some costs are fixed - Fixed costs are only fixed in the short run.
- a standardised product - Not all businesses produce a standardised product, in which case costs will be different for each order and the selling price will need to be different.
- all variable costs are constant, so, it ignores economies of scale and other factors that may affect variable costs. For a business purchasing supplies from abroad, such as BMF Ltd, the cost may also vary as a result of fluctuating exchange rates, inflation in other countries, or changes to tariffs on imports.
- that all output is sold - Sales may not actually equal output. There are numerous external
- factors outside a business's control that can affect the level of demand / sales.
- all output is sold at one price - In practice, firms may reduce their price to sell more.

SECTION 5 - FESTIVAL T-SHIRTS

How might selling through a website maximise efficiency and minimise costs?

Selling online provides access to a global market without the need to invest in shop premises, branch managers, shop floor staff, or as much stock of T-shirts and stationery.

The Purchasing of Supplies from a Company in China

China is one of the BRIC economies, along with Brazil, Russia and India. These are all developing economies ie countries with less industrialisation and lower living standards. Buying from suppliers in developing countries, such as China, could provide jobs for local people and help raise their standard of living. The BRIC economies ie Brazil, Russia, India and China are actually classed as 'emerging markets'. These are developing countries with a high rate of economic growth and industrialisation.

The T-shirts BMF Ltd has bought from the Chinese supplier to sell in the UK would be classed as imports. Imports are often subject to tariffs ie fees paid by the firm bringing goods produced in another country into the country. These would increase the cost for BMF Ltd. Also by producing them in a different country it makes it more difficult to control quality. Also the further away suppliers are, the greater the chance of delays in getting the supplies - due to the distance the goods have to travel.

How might exchange rates impact on the cost of the T-shirts BMF Ltd buys from China?

If the pound strengthened in relation to the yuan (eg £1 = 10 yuan) then the price BMF Ltd would pay for Chinese supplies of T-shirts (so its costs) would reduce, and profit would increase. If, on the other hand, the pound weakened in relation to the yuan (eg £1 = 8 yuan) then the price BMF Ltd would pay (and its costs) would increase and profit would reduce. The extent to which BMF Ltd would be affected would depend on how much there was a change between pound sterling and Chinese Yuan and the number of T-shirts BMF Ltd buys from Chinese suppliers.

The Use of Flow Production to Make T-shirts in Very Large Quantities

Flow production is the continuous production of a large quantity of identical items. Flow production often involves large investment in specialist machinery and is only suitable when very large numbers and continuous supply of the same product are required (eg for mass market products where there is high demand).

What are the advantages of flow production?

- Lower unit costs. This is because labour costs are low and also because large quantities are produced - and so there is maximum opportunity for the business to benefit from economies of scale
- Improved quality and increased productivity, (ie more T-shirts produced in a given period of time). This is because: production is set up in such a way to ensure there are no delays between processes; processes are often automated and machines are faster and more precise and reliable than humans; workers employed in the production process often specialise and so become experts ie quicker at their job and make fewer mistakes. Because of this they might get more repeat business so more sales and profit.

Disadvantages of flow production

- can be expensive to set up - due to the specialist equipment / machinery need
 - needs very careful planning in the way the stages of production are organised and type of machinery needed - to make sure there are no hold-ups due to shortages of components.
- Needs production line speeds to be carefully thought about which encourage workers not to waste time but which allow them enough time to complete their work to the required standard.
- can be inflexible - as a production line may be difficult to adapt once set up to produce a particular product.
- has, led to low job satisfaction - due to the repetitive nature of the job. (NB If this is found to be an issue, job rotation could be considered as an option to provide some job variety and help ensure output in terms of quality in particular, did not suffer as a result of falling levels of motivation).
 - If one part of the line breaks down the whole line is affected and production would have to stop until the line is repaired.
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The Use of Batch Production to Print Designs on T-shirts

Batch production is where a large or small quantity of the same item is produced at the same time. It is appropriate when a limited number of the same item is required for a limited amount of time. Workers often specialise in one particular process / job. For example, in the case of printed T-shirts, workers may specialise in just the printing process, or the drying process, or the packing process.

What are the advantages of batch production?

Unlike flow production, batch production enables a business to change from producing one type of product to another type of product and thus enables the business to produce a range of products to meet different customer requirements. This can help maximise sales and market share. For BMF it enables the Chinese supplier to change from printing one particular design on a number of its standard T shirts to a different design and, thus, take on different customer orders. Because workers often specialise, they become experts ie quicker at their job and make fewer mistakes. This can result in a greater number of products - than job production - being produced in a given period of time (ie higher productivity) and, thus, lower labour costs per unit and lower costs associated with poor quality.

What are the disadvantages of batch production?

- job satisfaction may be lower, as the work carried out may not be as varied
- batch production requires flexibility with regard to staff and equipment - to enable work to be easily switched from one batch of products, eg one type of printed T-shirt to another. Compared with flow production, it is necessary to clean down machinery between batches. This is unproductive downtime when the machinery is not producing goods.

Why is batch production used by the Chinese supplier for the printing of The Festival T-shirts?

- Batch production is suitable when a limited number of the same product is required for a limited period of time. It is, therefore, appropriate for the printing of BMF Ltd’s Festival T-shirts as only a limited number of T-shirts (in this case 5,000) with the same design are required to be printed at a certain time each year.

(ii) Explain one reason why the Chinese supplier uses batch production to print BMF Ltd’s Festival T-shirts.

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The Quote from the Chinese Supplier to Manufacture the Festival Tshirts for 2017

What are the total costs to BMF Ltd for each order quantity?

If BMF Ltd orders the Festival T-shirts this year from the Chinese supplier:

- 5,000 T-shirts will cost £25,000 (5,000 x £5).
- 10,000 T-shirts will cost £40,000 (10,000 x £4).
- 15,000 T-shirts will cost £30,000 (15,000 x £2).

Why does the cost per T-shirt fall the higher the quantity of T-shirts ordered?

The higher the quantity of shirts BMF Ltd purchases from the Chinese supplier the lower the cost (to BMF Ltd) per T-shirt. This is because by producing in larger quantities, the Chinese supplier is able to benefit from economies of scale, ie lower unit costs.

The Reports in the UK Newspaper Criticising the Chinese Supplier

These reports claimed the following:

- wages paid are very low.
- there are concerns over health and safety practices in its factories. The report also made suggestions that the supplier used too many non-renewable resources.

The Chinese supplier claims the reports are untrue.

There are ethical issues associated with using suppliers in emerging economies such as China. For example, less strict employment laws or lack of / less regulation, can result in the use of under-age workers / child labour, poor / unfair rates of pay (wages), low health and safety standards resulting in accidents, poor working conditions, as well as high pollution if the environmental effects of business activity are not controlled, which negatively affects the health of the local community. The issue for BMF Ltd is that if these reports are true and BMF Ltd continued to use the Chinese supplier for its Festival T-shirts, then this could negatively affect the image of BMF Ltd as a company that has 'the protection of the environment' as one of its core values, and that is running a Festival this year with the Theme 'Enjoying but protecting the environment AND its people'. Purchasing supplies from a company who makes use of too many non-renewable resources and is mis-treating its employees would seem hypocritical and suggest BMF Ltd is not committed to this year's Theme, or its core values. This could ruin their reputation.

Damage to their reputation might mean that less people will buy tickets so less profit but also mean that less companies want to sponsor them. Less people want to work there and make it less likely for the government to give them a grant in the future.

What should BMF Ltd do about this situation?

BMF Ltd should investigate whether any of these claims are true – do a surprise visit to the factory. If the allegations are true give them some time to correct the situation. This depends how long they have until they need to order the t-shirts in time for the festival. If they do not have reasonable time they should consider using an alternative supplier who is ethical.

What factors should BMF Ltd consider when choosing between suppliers?

If supplies are cheap – keeps costs down so they can have greater choice of the price to charge. BMF can have higher profits or choose to lower the price to customers by offering deals such as bulk buying discounts. If buying from outside the EU they also need to pay import tariff and this needs to be calculated into the costs. As does any change in exchange rate.

Payment for T Shirts

As BMF might need trade credit to buy the T Shirts it might be better to choose a company that has better credit terms even if the price is a bit higher.

Quality

Good quality T Shirts are important to avoid customer complaints, refunds, bad reputation. Any of these might make sales go down (which leads to less revenue and profit). As the t shirts are very popular it implies that there are no issues with the Chinese supplier. The UK supplier also claims to have excellent quality control systems.

Lead times

Lead times is the time between getting an order and delivering it. If there is a long lead time than BMF need to order the t shirts a long time in advance and then keep stock. This limits space and your money is tied up with the stock. BMF might want to look for a company which has shorter lead times

Reliability

This is important as BMF need the supplier to consistently deliver the right quality and quantity of supplies to the right place at the right time. Choosing a company because of low cost is not worth it if they are not reliable. The UK supplier claims to be very reliable.

Location/proximity to BMF and its customers

Buying supplies from developing economies such as China is cheaper due to low labour costs and the strength of the pound. However, there are potential problems with delays in transportation, risk of the exchange rate changing, if they are further away there are barriers to communication and its difficult to control quality and specifications if the first language is not English.

Ethical considerations.

More customers, employees and investors are taking into account whether a business is ethical – they may only use suppliers that have safe working conditions, no child or forced labour and work in an environmentally aware way.

Concluding remarks

For this topic – the Chinese supplier is cheap, this will maximise profit and the return to shareholders. At the moment the shareholders are not pleased with the performance of the company so Chinese supplier might be better. However, supplier need to fit with the core values – as these are probably the core values of the founders (shareholders) too.

The Business Analysts Suggestions that Some Chinese Firms are Becoming Too Big and May Begin to Experience Diseconomies of Scale

What are economies of scale?

Economies of scale are factors that lead to a reduction in unit (or average) cost as a business increases its output. (Remember, unit or average cost is the total cost of producing a certain level of output ie total fixed and total variable costs divided by the number of units produced). In other words, doubling the output results in less than double the unit costs. Also, variable cost (so average cost) per unit may actually be lower - due to discounts offered by suppliers on bulk purchases.

A business may benefit from any one, some, or all of the following economies as a result of an increase in the scale of production:

- Technical economies - moving to larger premises, and / or using more technologically advanced equipment, which larger businesses can more easily afford. More modern machinery is able to produce items more quickly and more reliably (with less error), and therefore, at a lower unit cost.
- Managerial economies - As a business grows, it may be able to split into a number of different departments and to employ specialist managers / directors eg in marketing, production and finance who become expert at overseeing one particular function (as opposed to average at overseeing several), thereby helping to maximise efficiency.
- Purchasing economies - The business may be able to receive discounts (or greater discounts) from suppliers (of the materials it uses to make and print its T-shirts eg fabric, paint / dyes, etc) for buying larger quantities of these materials (at any one time, or throughout the year), so reducing unit material (variable) costs.
- Marketing economies - Market research, advertising, selling and distribution costs may be spread across a greater output, so reducing unit costs.
- Financial economies - A business may also be able to raise capital eg a loan from its bank at a lower cost from interest rates - due to having larger assets (eg land and factory premises) to offer as security. Also, large businesses are likely to be more widely known and so might find it easier (so less expensive) to raise funds through members of the public (eg through shares), as people may be more willing to invest in a business they have heard of.
- Risk-bearing economies - As a business grows it may make a number of different products and serve a number of different markets. Diversifying into a number of different products and markets spreads risk, as it reduces dependence on one.

with lower unit costs, it can have profits, which would provide more money for reinvestment and / or higher dividends to its shareholder

What are diseconomies of scale?

A business will find that its unit costs start increasing as it suffers from diseconomies of scale. These are factors that cause unit cost to rise as a business increases its output. These arise from problems of managing large businesses:

- Co-ordination and control becomes much more difficult as a business increases in size and complexity. Regular meetings and increased supervision / checking procedures may be needed and so spending can increase in large firms.

- Communication. The larger the firm, the more levels communication has to flow through. This can result in slower decision making, decreased efficiency and increased costs. It can also result in workers feeling isolated and distanced from the business goals.
- Motivation. Greater supervision (in order to check and co-ordinate activities) and difficulties with communication can lead to poor relations between management and staff, and workers feeling alienated. This can lead to low morale and lack of motivation, and result in decreased productivity and / or increased absenteeism (sick days) and / or labour turnover (people leaving the company).

Diseconomies are more likely when the business has grown fast and has not put proper systems into place to cope.

(ii) Explain one type of diseconomy of scale that Chinese firms might suffer from as a result of 'becoming too big'.

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The Quotes from the Smaller, UK Supplier

How does this quote compare with the Chinese Supplier?

As with the Chinese supplier, the higher the quantity of shirts BMF Ltd purchases from the UK supplier, the lower the cost (to BMF Ltd) per T-shirt

the total cost for each of the different order quantities will be as follows:

- 5,000 T-shirts will cost £30,000 (5,000 x £6). This is £5,000 ie 20% more than the Chinese supplier.
- 10,000 T-shirts will cost £50,000 (10,000 x £5). This is £10,000 ie 25% more than the Chinese supplier.
- 15,000 T-shirts will cost £45,000 (15,000 x £3). This is £15,000 ie 50% more than the Chinese supplier.

The Claims Made by the UK Supplier Regarding Quality Control Systems

What is the meaning of 'quality' and 'quality control'

Quality is about providing the customer with a product or service that meets their requirements on a consistent basis. It does not necessarily relate to the most expensive or luxury good - as quality is 'in the eye of the beholder'.

Quality control is the process of inspecting and testing products to reduce the number of rejects in the production process and returns from customers

Why is ensuring quality / quality control so important?

Good quality is crucial to the success of a business. This is because good quality:

- minimises costs – ie the costs of re-working, re-testing, re-inspecting poor quality / 'failed' products, or time spent handling complaints, or lost sales and / or legal action and compensation resulting from dissatisfied customers.
- makes sure customers are satisfied and, can help generate sales through repeat business or new customers from positive word of mouth / recommendations.
- can help to gain a competitive advantage – If a business can improve the product it provides over and above that of competitors, in ways that customers value, this can help win customer orders from rivals.
- can charge a higher price – so higher profit margins and overall profit.
- can help to attract and keep good staff – people prefer working for a good quality company.

Good quality is important in maximising efficiency and competitiveness

What might the UK supplier’s quality control systems consist of?

UK supplier may employ specialist Quality Control departments / staff to carry out inspections at each stage of the production process. Ideally, however, employees involved in production should be responsible for checking their own work. This approach needs staff to be carefully trained on the importance of ‘right-first-time’ production. Staff only pass it on if they are happy with the quality/ This approach leads to less waste and lower costs as the product needs less reworking and you get less customer complaints. This also makes staff more motivated as they are given responsibility for each checking the quality and help improve their self- esteem. This idea of schlong their woprk is seen as Total Quality Management (TQM) . Staff take care and have pride in their work, they are involved in continuous improvement of products and processes, and aim ‘to do the right thing and do it right first time’. TQM makes every individual within the organisation responsible for quality and responsible for checking their own work and the work of others. TQM requires training to ensure highly capable and responsible staff, and to overcome potential barriers such as managers not wanting to give responsibility to staff and staff feeling uncomfortable being given the responsibility.

(ii) Explain one method of quality control that this smaller, UK supplier might use.

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The Different Options for Financing the Purchasing and Selling of the

The Case Study states that BMF Ltd has previously financed the purchasing and selling costs of the T-shirts using an overdraft, but that it is considering asking its supplier for trade credit or taking out a bank loan

What is an overdraft? What are the advantages and disadvantages?

Overdrafts are arrangements between a firm and its bank or building society to withdraw more money from its account than is in it, to an agreed limit. Overdrafts are simple, quick to arrange, flexible and convenient - as, once the agreement has been set up, the amount borrowed can vary up to the agreed limit and so can be changed to meet the size of the deficit, without having to go back and forth to the bank. However, overdrafts incur a cost, which reduces profit - as interest is charged on the amount overdrawn. , Overdrafts may be expensive if used regularly for large amounts, as a high level of interest is usually charged - between 2-4% over the bank’s base rate.

What is trade credit? What are the advantages and disadvantages?

Trade credit is where a business has an interest free period in which to pay for goods / services from a supplier. The typical credit period is between 30 to 70 days. The main advantage of trade credit is that it is interest free (unlike overdrafts and loans). The main disadvantage is that a business may lose out on discounts that it might have got before from paying when they buy the goods. This would increase the business’s costs and reduce profit margins.

What is a bank loan? What are the advantages and disadvantages?

A bank loan is when a bank lends a business a set amount of money and the business repays the amount over an agreed period of time, at an agreed rate of interest. Interest is fixed or variable. Most loans are short to medium term (up to 1 year, or between 1 to 5 years), and are used to purchase fixed assets or pay for the expansion. For the purchasing and selling of the T-shirts, a short term bank loan of just 2 or 3 months would be needed. Bank loans are straightforward to arrange (if the business has a good financial history) and, unlike overdrafts, there is no danger of the loan being recalled. However, the business has to pay regular interest payments which increases costs and reduces profit. Collateral (in the form of fixed assets such as land, buildings, equipment and vehicles) is also often

needed. Loans tend to be less flexible and more expensive than overdrafts - as repayments are fixed, and must be made on agreed dates. If the loan is variable, the business can take advantage of a fall in interest rates. Interest rates can increase though so a fixed rate may be better it also allows more accurate budgeting and forecasting.

Which method should BMF Ltd use?

BMF Ltd should first ask its supplier for **trade credit** because, unlike bank loans and overdrafts, this is interest free and so would not increase BMF Ltd's costs and reduce profit - as long as the business does not lose out on discounts for paying promptly. If BMF Ltd is likely to lose out on discounts for paying promptly, then they should compare the increase in price paid for the T-shirts from the lost discount to the interest paid on the bank loan or overdraft, and pick loan/overdraft if it works out less.

What will the total revenue, cost and profit of the 2017 Festival T-shirts be, if BMF Ltd continues to use the Chinese supplier?

The total revenue from selling the Festival T-shirts is calculated using the formula:

quantity sold x selling price per unit (T-shirt). Therefore:

Revenue in June: $600 \times £10 = £6,000$

Revenue in July: $1,400 \times £10 = £14,000$

Revenue in August: $2,800 \times £10 = £28,000$

Revenue in September: $200 \times £5 = £1,000$

Total revenue will be: £49,000

The total cost to buy the T-shirts from the Chinese supplier is calculated as follows:

quantity purchased x cost per unit. Therefore:

Total cost will be: $5,000 \times £5 = £25,000$

Profit is revenue - cost. Therefore:

Gross Profit will be: **£24,000**

- Gross Profit = Revenue – cost of sales (or 'variable costs' or 'direct costs').
- Net Profit = Gross profit – other (business) expenses (or 'fixed costs' or 'indirect costs' or overheads), which is also known as trading or operating profit.

There are other costs directly associated with each t-shirt e.g. packaging and postage. Other costs are fixed e.g. one off design costs. There are also indirect costs such as expenses like office admin.

We can calculate that for the 4 months of the year during which the T-shirts will be sold, these other costs are expected to amount to:

- £8,400 for 'Retail and distribution' ($£1,200 + £2,800 + £4,000 + £400$);
- £4,600 for 'Administration' ($£700 + £1,500 + £2,100 + £300$).

This comes to £13,000, if we deduct these other costs from the £24,000 profit figure calculate above, this would result in a figure for profit of £11,000. This figure might be classed as net profit. However, this would depend on how BMF Ltd classifies these other costs.

What if BMF Ltd used the smaller, UK supplier?

If BMF changed to the UK supplier we do not know whether BMF Ltd would increase price in line with the higher cost, say to £11 or £12 instead of £10, or whether they would keep the price the same and accept a lower profit margin. .In general, as price rises demand falls (and vice versa). Therefore, raising price could lead to less demand and sales. However, this depends on a number of factors, the Festival T-shirts have become 'very popular' and are seen as something as a 'collectors item' among outdoor pursuits enthusiasts so people may be willing to pay a higher price.

businesses, (especially businesses that sell to other businesses allow their customers to pay in the future, usually within 30 days, so, part of this profit may still be owed. A business may also have more cash in the bank than that equal to profit. This may be because it, too, has goods or services which it has not yet paid for

What are the benefits of cash flow forecasting?

Producing a cash flow forecast lets a business to see how much cash will be available in the business at a given point in the future. It will, therefore, enable BMF Ltd to:

- assess the business's ability to meet debts as they fall.
- identify any cash-flow problems
- plan and seek ways - in advance - to prevent a potential cash shortage.

Producing a cash flow forecast could also help BMF Ltd to:

- make key business decisions, for example, whether or not to: expand or reduce existing Festival activities; include new goods / services / activities; or invest in new / additional resources / facilities. This is because it would highlight potential cash flow problems that might come from such decisions /
- secure external finance eg in the form of a bank loan if required. This is because BMF Ltd's bank would use it to assess the business's future ability to meet interest payments and pay back any overdraft or loan taken out.
- control the business by setting targets, eg targets such as: using budgets; reducing Festival T-shirt inventory (stock) levels - to free up cash tied up in stock; increasing or reducing a bank overdraft by a certain amount by a certain date; increasing the credit period granted by suppliers for purchases.

Are there any limitations (problems) of cash flow forecasting?

- The cash flow forecast figures might be different to actual. This is because the forecast figures might be based on inadequate research / information.
- Forecasting cash flows can also be very difficult to do accurately because there are lots of factors affecting the forecast figures that are outside a business's control, some of which may be difficult to predict. For instance:
- Suppliers may unexpectedly put up prices, resulting in costs (expenditure) being higher than forecast.
- A change in income tax or interest rates could affect BMF Ltd's forecast for sales (income from cash inflows) by increasing or reducing demand for its products (as people have more or less income to spend on goods and services), as well as its expenditure (cash outflows) - if BMF Ltd has funded investment on borrowed funds eg an overdraft or bank loan.

What does the cash flow forecast for the sales of the 2017 Festival T-shirt tell us?

BMF Ltd is likely to make a profit on the selling of The Festival T-shirts.

- However, in terms of cash flow, the cash flow forecast for the sale of the 2017 Festival T-shirts (Fig. 6) predicts a cash shortfall of £20,900 in June. This seems to be the result of paying £25,000 outright for the supply of T-shirts, with the sale of T-shirts not being enough during this month to cover this payment (as well as other costs being due).
- This cash shortfall reduces by £9,700 (ie by 46.41%) down to £11,200 ($\frac{£20,900 - £11,200}{£20,900} \times 100$) in July, despite an increase in retail and distribution costs and administration, as sales of the T-shirts start to rise and cancel out the other costs.
- The cash flow forecast shows a surplus in August of £10,700, as sales of the T-shirts reach a peak during this month - double what they were the previous month, and this surplus rises slightly to £11,000 in September.

Learn percentage changes and how to calculate !

- ✓ Income received on sales in August is forecast to be £14,000 ie 100% more than income received from sales in July and £22,000 ie 366.67% more than income received from sales in June.
- ✓ Retail and distribution costs in July are forecast to be £1,600 ie 133.33% more than retail and distribution costs in June and £1,200 ie 42.86% less than retail and distribution costs in August.

To calculate percentage changes you take the higher figure from the lower figure, divide by the original figure, and multiply the resultant figure by 100

How might BMF Ltd solve the predicted cash shortfall?

- They could use overdraft, short-term bank loan, or trade credit for financing the purchasing and selling costs of the T-shirts (see above)
- They could also reduce debtors by offering discounts for prompt payment,

Who earns the revenue and profits from the food stalls and bars?

The case study does not suggest that BMF Ltd gets revenue from the food stalls and bars.

Will these businesses be in competition with each other?

Yes there is a competitive environment, which will make businesses to look carefully at how they can meet customers needs by:

- lower prices, which reduces profit margins, unless costs can also be reduced.
- superior products eg better tasting (in terms of food), more longer-lasting material, improved design (in terms of outdoor pursuits clothing) that more closely meets the needs / expectations of customers. Thus, competition encourages firms to innovate and to develop new and improved products.
- incentives eg free gifts.
- superior delivery eg faster or more reliable delivery.
- superior customer service eg more friendly, helpful staff.

How can competition benefit consumers?

Competition gives customers / consumers:

- greater choice - because there are a number of competing sellers and each seller will want to make their products different from other producers in order to maximise sales.
- better value - as the presence of competition encourages firms to be more efficient in order to offer lower prices and / or to offer greater product / service benefits, including faster delivery or after sales service, in order to win sales from competitors.

Governments may encourage competition are that it reduces prices, increases choice, and improves efficiency and levels of service.

The Prices of the Large National Chains Selling Outdoor Pursuits

Why are these national chain retailers able to sell at lower prices?

As an independent single outlet, Spirit of Adventure will have less chance for internal economies of scale than a large national chain of retailers and so may not be able to be as competitive on price, due to higher costs. For example, a national chain of retailers will need much larger quantities of supplies from the manufacturers of the products it sells than Spirit of Adventure- as they have many retail outlets to stock across the country, not just one. Because of this they will be able to get discounts for bulk buying (purchasing economies of scale).

Why do these national chain retailers offer additional discounts on goods sold from their stalls on The Festival Field?

Because there is a lot of competition from the other retailers (21 other stalls), lower prices might win customers increasing demand.

The Additional Stock Spirit of Adventure Buys in to Sell During the Festival Weekend

The fact that Spirit of Adventure buys in additional stock to sell during The Festival weekend suggests that the demand for its products during this time increases. This shows that price is not the only factors customers take into account, the quality might be better at Spirit of Adventure. By buying more stock 'Spirit of Adventure is trying to avoid a stockout which would mean they lost sales (because they would have nothing to sell).

How might Spirit of Adventure fund this investment in additional stock?

Additional stock should be financed by **income from sales**, but sometimes there might be a gap as they wait for money to come in from sales, sometime finance is needed to fill the gap.

Method Description Advantages Disadvantages

Method	Description	Advantages	Disadvantages
Trade Credit	Securing an interest free period in which to pay for goods / services received. The typical credit period is between 30 to 70 days.	Interest free (unlike overdrafts).	Possible loss of discount for prompt payment.
Overdrafts	Arrangements between a firm and its bank / building society to withdraw more money from its account than that deposited in it, up to an agreed limit.	<ul style="list-style-type: none"> • Simple, quick to arrange. • Flexible and convenient. • Relatively cheap in the short-term - as interest is only charged on the outstanding bank balance at the end of each day. 	<ul style="list-style-type: none"> • Increased costs and reduced profit arising from interest payments. • Expensive if used regularly for large amounts as interest is usually charged at 2-4% over the bank's base rate. • Repayable on demand - can be recalled without notice.

What costs are associated with holding additional stock?

Buying additional stock might help Spirit of Adventure get a discount for buying a larger quantity at any one time, which would help it to get a higher profit margin on any stock sold during The Festival weekend ((assuming prices are kept the same)There are, however, costs involved in holding stocks:

- Cost of storage –purchasing or renting storage space, heating, lighting and insurance (against fire and theft).
- Cost of finance – A business may have had to borrow to purchase stock, e.g. overdraft for example, because it takes time to sell goods and get the money from customers.
- Theft, damage, deterioration, or obsolescence – If employees know there is plenty of ‘back-up’ stock they may take less care when handling items - more might become damaged, or stolen or go out of fashion.
- Opportunity cost – Money tied up in stocks cannot be used until that stock has been sold and paid for. Opportunity cost is the interest that could be earned on this money or instead the money could be re-invested in the business.

(d) Section 6, lines 117-118 state that Spirit of Adventure buys in additional stock to sell during The Festival weekend.

Identify and explain **one** cost to Spirit of Adventure of carrying a higher level of stock.

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Please tear this page out, complete and return to Mrs Hughes
Thank you

Student Name:

Please sign to confirm that your son/daughter is actively using this guide
(questions answered/key words or concepts highlighted)

Parental Signature :

Date:

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