

Version 1.0



**General Certificate of Secondary Education  
June 2011**

**Applied Business**

**413007**

**Business Finance**

**Unit 7**

***Mark Scheme***

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1

**Total for this question: 21 marks**

**1 (a)** Some of the costs for Partytime are listed in the table below.

Complete the table to identify whether the costs are fixed or variable. Place **one** tick in the appropriate column for each cost. (3 marks)

Cost	Fixed Cost	Variable Cost
Annual lease on van	✓	
DJ hire per event		✓
Refreshments at prom nights		✓

**1 (b)** Using **Item A**, explain why it is important to Jaswinder and Kate to identify whether these costs are fixed or variable. (3 marks)

**Answers can include:**

- an explanation that variable costs need to be covered before a contribution to fixed costs can be made
- at Level 3 the explanation could include:
  - annual fixed costs of £10 000 to be covered
  - the lease on the van would need still need to paid even if there was no work
  - they would need to ensure profit margins are high enough to cover the cost of the van.

Level	Descriptor	Marks	Assessment Objective
3	Candidate explains why it is important to identify whether costs are fixed or variable costs for Jaswinder and Kate.	3	AO2
2	Candidate describes features of fixed or variable costs.	2	
1	Candidate identifies feature of fixed or variable costs.	1	AO1

**1 (c)** Using **Item A**, explain the effect on Partytime's break-even if average variable costs increased to £1500 per prom night. (6 marks)

**Answers can include:**

- the break-even point would rise
- they would need to sell more to break-even
- break-even point would rise to 20 (by 4 parties)
- they may need to charge higher prices for the prom nights.

Level	Descriptor	Marks	Assessment Objective
3	Candidate explains the effect of the change in break-even on <i>Partytime</i> .	6–5	AO2
2	Candidate describes the effect of the change in break-even.	4–3	
1	Candidate shows understanding of break-even.	2–1	AO1

**1 (d)** *What actions could Jaswinder and Kate take if average variable costs increased? Explain why your actions would help them break-even. (9 marks)*

**Answers can include:**

- increase prices: This would reduce the amount needed to break-even. To bring back break-even to the original 16 the average selling price would need to rise to £21.25, which is quite a large rise. Would all the customers be prepared to pay the increase?
- try and reduce other variable costs
  - It would not really be feasible to reduce petrol costs but possibly a cheaper DJ could be employed. The success would depend on how important the DJ is to the customers
- provide a cheaper sound system (which could be either fixed or variable) or refreshments. Again, what effect would this have on the perception of customers to the quality of the event?
- other arguments such as increased promotion etc could be acceptable providing there is recognition that this would initially increase costs but might stimulate demand
- candidate can gain credit for trying to quantify the action
- reduce prices in order to attract more sales. Calculations of likely effects can be shown. But how feasible?

**Judgements could include:**

- likely success of the action on reducing break-even
- the action in context.

Level	Descriptor	Marks	Assessment Objective
3	Analyses effect of action(s).	4–3	AO3
2	Describes action(s).	2	AO2
1	States relevant action(s).	1	AO1
0	No valid response.	0	

**Note:** AO3 also assesses candidates' quality of written communication. When deciding on the AO3 level to be awarded, consider the degree to which the candidate orders and communicates his/her ideas.

Level	Descriptor	Marks	Assessment Objective
E2	Judges benefit of action with clear justification. Ideas are communicated using a logical structure, with some appropriate use of technical terms. There are occasional errors in accepted conventions of written communication.	5–3	AO3 and Quality of written communication
E1	Judges benefit of action with limited justification. Ideas are communicated with some structure evident with occasional use of technical terms. There are noticeable errors in accepted conventions of written communication.	2–1	

2

Total for this question: 19 marks

**2 (a)** Complete the cash-flow forecast for Partytime by inserting your answers in the shaded boxes below. (4 marks)

<b>Partytime</b>				
<b>Cash-flow forecast for the four months ended 30 June 2010</b>				
	<b>March £</b>	<b>April £</b>	<b>May £</b>	<b>June £</b>
<b>Cash In</b>				
Sales from prom nights				14 000
Sales from children's parties		600	900	900
Total inflow		600	900	14 900
<b>Cash Out</b>				
Cost of children's parties		300	450	450
Purchase of computing equipment	2 300			
Web design and set-up	2 000			
Other costs	1 390	490	480	670
Total outflow	5 690	790	(1) 930	1 120
<b>Net Monthly Cash Flow</b>	(5 690)	(190)	(30)	(1) 13 780
Opening balance	3 000	(1) (2 690)	(2 880)	(2 910)
Closing balance	(1) (2 690)	(2 880)	(2 910)	10 870

**2 (b)** Explain why preparing the cash-flow forecast in 2(a) could be useful to Partytime. (6 marks)

**Answers can include:**

- as it is a forecast it can identify when shortages of cash may occur, such as March-May. This is particularly useful for a new business that has to pay out high start up costs
- can inform owners of when an overdraft might be required such as March-May. Also shows that if the forecast is correct that they will exceed their overdraft facility
- provides opportunities to run 'what if' scenarios, e.g. increase in petrol prices or DJ fees. Spreading the cost by leasing computer equipment.

Level	Descriptor	Marks	Assessment objective
3	Candidate explains how this cash-flow forecast can help <i>Partytime</i> .	6-5	AO2
2	Candidate describes Partytime's cash-flow forecast.	4-3	
1	Candidate states use(s) of a cash-flow forecast	2-1	AO1

**2 (c)** *Partytime is forecast to have a cash-flow problem during its first three months of trading.*

*Using **Item B** and your answer to 2(a), do you think that asking customers to pay a 50% deposit is the best way to solve Partytime’s cash flow problem? Give reasons for your answer. (9 marks)*

**Answers can include:**

**In favour of a 50% deposit:**

- this will help with cash-flow because it will mean that there will be some money coming in to help with start-up costs etc
- the amount of money coming in from deposits would not really help cash flow much in March, April or May but would be good in the long run, so worth considering. Most prom nights (or teenager’s parties) are booked well in advance.

**Against 50% deposit/alternatives to 50% deposit:**

- will asking for a deposit put customers off using Partytime?
- there are alternatives such as reducing expenditure
- need to consider the implications of each item of expenditure
- would cheaper DJs be acceptable to customers
- leasing a smaller van
- similar arguments for cheaper/less computing equipment.

There is an overdraft facility of £2000 so not all the shortfall needs to be covered.

Level	Descriptor	Marks	Assessment Objective
3	Analyses effect of asking / not asking for a deposit on <i>Partytime’s</i> cash flow.	4–3	A03
2	Describes how asking / not asking for a deposit will affect <i>Partytime’s</i> cash flow.	2	A02
1	Identifies features of paying a deposit.	1	A01
0	No valid response.	0	

**Note:** AO3 also assesses candidates' quality of written communication. When deciding on the AO3 level to be awarded, consider the degree to which the candidate orders and communicates his/her ideas.

Level	Descriptor	Marks	Assessment Objective
E2	Offers judgement plus clear justification. Ideas are communicated using a logical structure, with some appropriate use of technical terms. There are occasional errors in accepted conventions of written communication.	5–3	AO3 and Quality of written communication
E1	Offers judgement plus limited justification. Ideas are communicated with some structure evident with occasional use of technical terms. There are noticeable errors in accepted conventions of written communication.	2–1	

3

**Total for this question: 20 marks**

**3 (a)** Complete the Profit and Loss Account for Partytime for the year ended 28 February 2011 by filling in the **shaded** boxes in the table below. (3 marks)

<b>Partytime Profit and Loss Account for the year ended 28 February 2011</b>		
	£	£
Sales revenue		52 500
Cost of sales		36 750
Gross profit		(1) 15 750
<i>Expenses</i>		
Start-up costs	4 300	
Other costs	6 725	
<i>Total expenses</i>		(1) 11 025
Net profit		(1) 4 725

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**3 (b)** Explain why the bank may have asked to see the Profit and Loss Account in **3(a)** before agreeing to the loan. (3 marks)

**Answers can include:**

- To see how much profit is made (L1) in order to see if the loan can be repaid (L1)
- To see the expenses of the business (L1).

Level	Descriptor	Marks	Assessment objectives
2	Explains why the bank may have asked to see the profit and loss account in 3(a) before agreeing to <i>Partytime's</i> loan.	3	AO2
1	States reason(s) why a bank might want to see a profit and loss account before agreeing to a loan.	2–1	AO1

**3 (c)** *Jaswinder has calculated some financial ratios for Partytime.*

*Using Figure 1, explain what they show him.*

*(5 marks)*

**Answers can include:**

- the gross profit margin shows how much gross profit the business earns from each £1 worth of sale. (L1) The industry averages are between 25% and 35% so *Partytime* is comfortably within the range but there is scope to improve (L2)
- the net profit margin shows how much net profit the business earns from each £1 of sales (L1). *Partytime* is below the industry average which suggests that their expenses are higher than competitors and this is something they should address (L2)
- the business is new so the good gross profit margins are encouraging and the net profit margins may improve over time.

Level	Descriptor	Marks	Assessment objectives
2	Explains what the financial ratios in Figure 1 show about the performance of Partytime.	5–3	AO2
1	States what financial ratios show.	2–1	AO1

**3 (d)** Using **Item C** and your answer to **3(a)** do you think that Jaswinder and Kate should give up their jobs and enter the wedding reception market? Justify your answer. (9 marks)

**Answers can include:**

**For:**

- they look to be making a net profit in their first year of 9% which is good for a new business and is a very good return
- if they make profits of £60 000 with the weddings then this will be £30 000 each which is £11 000 more each than they currently earn
- some of the costs of expansion might not be required in future years
- the more things that they do the better they will become known so the wedding reception market may generate some business for the party market
- gross profit margins are within the industry average range.

**Against:**

- the figures for future profits are all estimates they might not be accurate particularly given the current economic climate
- if they are currently struggling to control costs, this might become more difficult as the business expands
- currently their jobs are secure and between their salaries and current forecasted profits they are making nearly £19 000 each with little risk. The loan would need to be secured against their own personal possessions
- they will need to pay back the loan and interest. This will mean they will need to pay out another £5000 in expenses before they can make a profit. If they do not make a profit they will not get paid
- net profit margin is lower than their competitors.

Level	Descriptor	Marks	Assessment Objective
3	Analyses profitability of <i>Partytime</i> .	4–3	A03
2	Describes issues regarding profitability of <i>Partytime</i> .	2	AO2
1	Demonstrates understanding of profitability.	1	AO1
0	No valid response.	0	

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E2	Offers judgement plus clear justification. Ideas are communicated using a logical structure, with some appropriate use of technical terms. There are occasional errors in accepted conventions of written communication.	5–3	AO3 and Quality of written communication
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