Edexcel

AS Level

BS

(Code: WEC13 01)

Unit 02

Managing finance

Chapter 34 – Profit

PROFIT

As explained in Chapter 29, if total costs are subtracted from total revenue this gives business's profit. This is the money left over after all costs have been met, and belongs to the owners of the business. Accountants calculate and define profit in a number of ways.

Gross profit: Gross profit is the difference between revenue or turnover and cost of sales.

• Turnover, also called revenue or sales revenue, can be calculated as price x quantity of sales.

• Cost of sales are the direct costs of a business.

• Gross profit is the profit made by a business after direct costs have been met.

For a retailer or wholesaler, the cost of sales is the cost of buying in stock to re-sell. For a manufacturer the cost of sales is any costs associated directly with production, such as raw materials, factory wages and other direct costs. For a supplier of services it is any direct costs, such as direct labour. Gross profit is calculated by:

Gross profit = Revenue - Cost of sales

Operating profit: Operating profit is the difference between gross profit and business overheads. Overheads are indirect costs, such as selling and administrative expenses. Operating profit is calculated by:

Operating profit = Gross profit - Operating expenses

Profit for the year (net profit): Profit for the year or net profit is the profit made by the business for the year. It is the difference between operating profit and finance costs (interest paid on loans) and any other exceptional costs. Net profit may be calculated before or after the subtraction of taxation. It is calculated by:

Profit for the year (net profit) = Operating profit-finance costs (and exceptional costs)

WAYS TO INCREASE PROFIT

Most businesses will want to increase their profits if it is possible. One approach is to increase profitability. This involves raising prices or lowering costs per unit. This is discussed later in this chapter. Also, a business might use one, or more, of the following approaches to raise the overall level of profits for the business.

Adjust the marketing strategy: A business could use a range of marketing techniques to increase its revenues.

Find new markets: A business could generate more sales by finding new markets for its products.

Diversify: A business can increase its revenue and profit by extending its product lines or producing completely new products.

Mergers and takeovers: Some businesses try to grow their profits by joining together with others. They might, Alternatively, a business may diversify by acquiring another firm in a completely different field.

Disposal of non-profitable activities: Some businesses may be in a position where they can increase profits by getting rid of poorer performing parts of their business. This is particularly the case if a business has a product or a division that is making a loss.

Citroen, expressed an interest. It was reported that Opel had lost up to US$15,000 million for GM since 2000. In March 2017, it was reported that PSA had agreed to pay €2200 million for Opel. Clearly, if a business can 'off-load" a loss-making section of its operations, overall profit will improve immediately.

STATEMENT OF COMPREHENSIVE INCOME (PROFIT AND LOSS ACCOUNT)

At the end of the trading year, businesses produce documents that show key information relating to the financial performance of the business. One of these documents is the statement of comprehensive income. An example from a statement for Forest Way Autotraders Ltd, a second-hand car dealer, is shown in Table 2.

	2017 (£)	2016 (£)
Revenue/turnover	561,000	498,200
Cost of sales	331,000	322,100
Gross profit	**230,000**	**176,100**
Selling expenses	45,300	38,200
Admin expenses	122,500	102,800
Operating profit	**62,200**	**35,100**
Finance costs	22,100	21,000
Profit for the year (net profit)	**40,100**	**14,100**
Taxation	8000	2800
Profit for the year (net profit) after tax	**32,100**	**11,300**

▲ Table 2 Selected information from the statement of comprehensive income for Forest Way Autotraders Ltd, year ending 31 January 2017

MEASURING PROFITABILITY

The information contained in the statement of comprehensive income can show how well a business is performing. This is a significant increase. However, it is possible to measure the profitability of a business in a more meaningful way. This can be done by calculating profit margins, which measure the size of profit in relation to revenue/turnover. Three profit margins can be calculated.

Gross profit margin: The gross profit margin shows the gross profit made on sales turnover/revenue. It is calculated using the formula:

$$\text{Gross profit margin} = \frac{\text{Gross profit}}{\text{Revenue}} \times 100\%$$

Higher gross margins are usually preferable to lower ones because it means that more gross profit is being made per £1 of sales. The gross profit margin:

- may be increased by raising revenue/turnover relative to the cost of sales, by increasing price
- may be increased by cutting the cost of sales; this might be achieved by finding cheaper suppliers of key materials
- will vary between different industries. As a rule, the quicker the turnover of inventory, the lower the gross margin that is needed.

Operating profit margin: The operating profit margin shows the operating profit made on sales revenue/turnover. Operating margin is used to measure a company's pricing strategy and operating efficiency. It gives an idea of how much a company makes (before finance costs and taxes) on each pound of sales. It is calculated using the formula:

$$\text{Operating profit margin} = \frac{\text{Operating profit}}{\text{Revenue}} \times 100\%$$

Profit for the year (net profit) margin: The profit for the year (net profit) margin or net profit margin takes into account all business costs, including finance costs, other non-operating costs and exceptional items. It is also usually calculated before tax has been subtracted.

The profit for the year (net profit) margin can be calculated by:

$$\text{Profit for the year (net profit) margin} = \frac{\text{Net profit before tax}}{\text{Revenue}} \times 100\%$$

WAYS TO IMPROVE PROFITABILITY

All businesses will want to improve their performance. An improved performance is likely to benefit all stakeholders. The returns on capital can be increased by making more profit with the same level of investment. This might be achieved by growth funded externally. This means the business increases sales using fresh capital.

Raising prices: If a business raises its price it will get more revenue for every unit sold. If costs remain the same then profitability should improve. However, raising price might have an impact on the level of sales. Generally, when price is raised demand will fall.

Lowering costs: A business can also raise profit margins by lowering its costs. It can do this by buying cheaper resources or using the existing resources more effectively.

• Buying cheaper resources. It might be possible to buy raw materials and components from new suppliers that offer better prices. It may also be possible to find new providers of essential services such as telecommunications, electricity, insurance and IT support.

• Using existing resources more efficiently. Making better use of current resources will improve efficiency and lower costs. A business might do this by introducing new working practices or training staff. This would help to raise labour productivity. It could upgrade its machinery by acquiring newer, more efficient models. This would raise capital productivity.

Chapter 35 – Liquidity

DISTINCTION BETWEEN CASH AND PROFIT

It is important for businesses to recognise the difference between cash and profit. At the end of a trading year it is unlikely that the value of profit will be the same as the cash balance. Differences between cash and profit can arise for a number of reasons.

• During the trading year a business might sell £200,000 worth of goods with total costs of £160,000. Its profit would be £40,000. However, if some goods had been sold on credit, payment by certain customers may not yet have been received. If £12,000 was still owing, the amount of cash the business had would be £28,000 (£40,000-£12,000). Thus, profit is greater than cash.

• A business may receive cash at the beginning of the trading year from sales made in the previous year. This would increase the cash balance but would not affect profit. In addition, the business may buy resources from suppliers and not pay for them until the next trading year. As a result, its trading costs will not be the same as cash paid out.

• Sometimes the owners might introduce more cash into the business. This will increase the cash balance but will have no effect on the profit made. This is because the introduction of capital is not treated as business revenue in the profit and loss account. The effect will be the same if a business borrows money from a bank.

• Purchases of fixed assets will reduce cash balances but will have no effect on the profit a company makes. This is because the purchase of assets is not treated as a business cost in the profit and loss account.

• Sales of fixed assets will increase cash balances but will have no effect on profit unless a profit or loss is made on disposal of the asset. This is because the cash from the sale of a fixed asset is not included in business turnover.

• The amount of cash at the end of the year will be different from profit because at the beginning of the because all resources purchased by a business have to be financed from either capital or liabilities.

Therefore: Assets = Capital + Liabilities

STATEMENT OF FINANCIAL POSITION (BALANCE SHEET)

Many businesses produce a statement of financial position at the end of the financial year. This document can also be called a balance sheet. It is like a photograph of the financial position of a business at a particular point in time. It provides a summary of its assets, liabilities and capital.

• Assets. The resources owned by a business. Examples include buildings, machinery, equipment, vehicles, stock and cash. Businesses use assets to make products or provide services. Liabilities. The debts of the business, in other words what it owes to others.

• Liabilities are a source of funds for a business. They might be short term, such as an overdraft, or long term, such as a mortgage.

• Capital. The money put into the business by the owners. Along with other sources of finance it is used to buy assets.

This is because all resources purchased by a business have to be financed from either capital or liabilities. There fore;

Assets = Capital + Liabilities

The presentation of the statement of financial position (balance sheet)

The presentation of these statements varies between different businesses.

Non-current assets: Non-current assets are long-term resources that will be used repeatedly by the business over a period of time. They may be called fixed assets. Common examples include land, property, plant, equipment, tools, vehicles, and fixtures and fittings. Intangible assets are also included in this category. These are non-physical assets, such as customer lists, franchising agreements and brand names.

Current assets: Current assets are assets that will be changed into cash within 12 months. They are liquid assets. The liquidity of an asset is how easily it can be converted into cash. Common examples include:

- inventories, such as stocks of raw materials, components and finished goods
- trade and other receivables, which relate to money that is owed to the business - examples might be debtors (the money owed by customers) and prepayments (where a business has paid in advance for a resource, such as insurance)
- cash or cash equivalents, which usually refers to cash on the business premises and money held in bank accounts.

Current liabilities: Any sums of money owed by a business that must be repaid within 1 year are called current liabilities. Examples include:

- loans and other borrowings, which include short- term bank loans and bank overdrafts
- trade and other payables, which refer to money owed by the business to suppliers of raw materials, components, business services and utilities - these are sometimes called trade creditors

- current tax liabilities: a business is likely to owe money to the tax authorities - this might include employees' income tax, VAT and corporation tax (tax must be paid within 1 year).

Non-current liabilities: Non-current liabilities relate to long-term loans and any other money owed by the business that does not have to be repaid for at least 1 year. Long-term bank loans, mortgages and company pension funds are examples.

Net assets: Net assets are calculated by subtracting the value of total liabilities from total assets. This will be equal to shareholders' equity at the bottom of the balance sheet.

Shareholders' equity: The final section of the balance sheet is the shareholders' equity. This provides a summary of what is owed to the owners of the business. Share capital and retained earnings (retained profit) are common examples.

	2014 (£ million)	2013 (£ million)
Non-current assets		
Property and equipment	176.5	189.3
Intangible assets	45.2	41.6
	221.7	230.9
Current assets		
Inventories	32.1	28.3
Trade and other receivables	7.3	6.8
Cash and cash equivalents	3.1	6.2
	42.5	41.3
Total assets	**264.2**	**272.2**
Current liabilities		
Trade and other payables	25.6	24.9
Current tax liabilities	11.1	10.5
	36.7	35.4
Non-current liabilities		
Loans	24.5	26.1
Pensions	7.8	6.7
	32.3	32.8
Total liabilities	**69.0**	**68.2**
Net assets	**195.2**	**204.0**
Shareholders' equity		
Share capital	25.0	25.0
Retained earnings	170.2	179.0
Total equity	**195.2**	**204.0**

▲ Table 1 Statement of financial position for Kingham plc, 2014

EQUATIONS FOR KEY VALUES IN THE STATEMENT OF FINANCIAL POSITION

To calculate the key values shown in the statement of financial position the following equations can be used.

Total assets = Non-current assets + Current assets

In Table 1 this is £221.7 million + £42.5 million = **£264.2 million**.

Total liabilities = Current liabilities + Non-current liabilities

In Table 1 this is £36.7 million + £32.3 million = **£69 million**.

Net assets = Total assets – Total liabilities

In Table 1 this is £264.2 million – £69 million = **£195.2 million**.

Total equity = Share capital + Other money owing to shareholders

In Table 1 this is £25 million + £170.2 million (retained earnings) = **£195.2 million**.

Note that Net assets (£195.2 million in Table 1) = Total equity (£195.2 million in Table 1). This will always be the case.

WHAT IS MEANT BY LIQUIDITY?

Liquidity is a very important issue for businesses. Liquidity refers to the ease with which assets can be converted into cash. Non-current assets such as property, plant, machinery and tools are not liquid assets. This is because they cannot be converted into cash very quickly.

MEASURING LIQUIDITY

Information contained in the balance sheet can be used to measure the liquidity of a business. It is important that a business is able to meet its short-term debts. This means a business must have enough liquid resources to pay its immediate bills. Failure to do so could result in the financial collapse of the business. Two financial ratios can be used to measure liquidity.

Current ratio: The current ratio is a liquidity ratio and focuses on the current assets and current liabilities of a business. It can be calculated using the formula:

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

A business is generally regarded as having sufficient liquid resources if the current ratio is between 1.5:1 and 2:1. If the current ratio is below 1.5 it could be argued that the business does not have enough working capital. This might mean that a business is overborrowing or overtrading (doing more business than can be supported by the resources available).

Acid test ratio: The acid test ratio is a more severe test of liquidity. This is because inventories (stocks) are not treated as liquid resources. There is no guarantee that inventories can be sold and they may become obsolete or deteriorate. They are therefore excluded from current assets when calculating the ratio. The acid test ratio can be calculated using the formula:

$$\text{Acid test ratio} = \frac{\text{Current assets} - \text{Inventories}}{\text{Current liabilities}}$$

If a business has an acid test ratio of less than 1:1 it means that its current assets minus inventories do not cover its current liabilities. This could indicate a potential problem.

WAYS TO IMPROVE LIQUIDITY

Liquidity problems can be prevented by keeping a tight control on financial resources. The use of budgets and cash flow forecasts will improve the financial management of a business. Inevitably though, there will be occasions when firms run short. When this does happen the firm's main aim will be survival rather than profit.

Sale of assets or leaseback: One approach to improve liquidity is to sell assets for cash. A business may sell unwanted physical assets such as vehicles, property or machinery. It could also sell financial assets such as shares or bonds. It may also decide to sell off part of its operations.

Alternatively, assets like property and machinery can be sold to financial specialists and leased back. This means that cash can be raised and the business can continue to use the assets. However, it may take a while to set up such agreements and can be an expensive way to fund assets in the long term.

Supplier credit terms: A business can save cash if it delays paying suppliers for goods and services that have already been bought. It may be able to extend its credit payment period from 30 to 60 days, for example. However, delaying for too long could mean that suppliers withdraw their credit facilities or refuse to deliver goods in the future.

Factoring: When businesses sell their products they send invoices to customers stating the amount due. The invoice provides evidence of the sale made and the

Inventory JIT: A business can improve its liquidity by reducing its inventories. Inventories are not likely to be very liquid so minimising their value will help to preserve cash. One approach to minimising inventories is to operate a just-in-time (JIT) method of production.

WHAT IS WORKING CAPITAL?

Working capital, sometimes called circulating capital, is the amount of money needed to pay for the day-to-day trading of a business. A business needs working capital to pay expenses such as wages, electricity and gas charges, and to buy components to make products. The working capital of a business is the amount left over after all current debts have been paid. It is:

- the relatively liquid assets of a business that can easily be turned into cash (cash itself, inventories, the money owing from debtors who have bought goods or services); minus
- the money owed by a business which needs to be paid in the short term (to the bank, to creditors who have supplied goods or services, to government in the form of tax or shareholders' dividends payable within the year).

In the balance sheet of a company, working capital is calculated by subtracting current liabilities from current assets:

Working capital = Current assets - Current liabilities

The amount of working capital a business has is an important issue. It can reflect how well a business is performing.

MANAGING WORKING CAPITAL

Different businesses have different working capital needs.

Size of business: Sales typically generate a need for stocks, trade credit and cash. Hence the larger the business, the larger the amount of working capital there is likely to be. Equally, expanding businesses are likely to need growing amounts of working capital.

Inventory levels: Businesses in different industries have different needs for inventory. A window cleaning business is unlikely to carry much inventory. A retailer is likely to carry considerable amounts of stock. Businesses which are able to adopt just-in-time techniques will carry lower levels of inventory than other businesses.

Debtors and creditors: The time between buying inventory financed by trade credit and selling finished products can influence levels of working capital. For example, a builder may need high levels of working capital because the

Maintaining adequate levels of working capital: Businesses need to keep adequate levels of working capital. If they keep too little (i.e. current assets are too low and current liabilities are too high) they will start to encounter trading problems.

• If a business does not carry enough inventory of raw materials, it could find that production stops when items run out. If it does not carry enough finished goods, it might be unable to fulfil orders on time.

• If there is not enough cash in the business, it might not be able to pay its bills on time.

• If it has borrowed too much through trade credit, so it owes too much to creditors, it might be unable to pay invoices when they are due.

However, a business does not want too much working capital (i.e current assets are too high and current liabilities are too low).

• Inventories are costly to keep. The more inventory, the higher the cost of physically storing and handling it. The inventory will need to be insured while it may be at risk of shrinkage (a business term for theft, usually by employees). Inventory is also financially expensive because money tied up in it could be used to reduce borrowing and so save interest for the business.

• Too much cash is also a problem because the cash is unlikely to be earning very high rates of interest. It could be used, perhaps, to pay back debts or to invest in higher interest long-term investments.

THE IMPORTANCE OF CASH

Cash is the most liquid of all business assets. A business's cash is the notes and coins it keeps on the premises and any money it has in the bank.

SUBJECT VOCABULARY

acid test ratio similar to the current ratio but excludes stocks from current assets. A more severe test of liquidity.
assets resources that belong to a business.
capital money put into the business by the owners.
current assets liquid assets, i.e. those assets that will be converted into cash within 1 year.
current liabilities money owed by the business that must be repaid within 1 year.
current ratio assesses whether or not a business has enough resources to meet any debts that arise in the next 12 months. It is found by dividing current liabilities into current assets.
debt factoring when a financial institution called a factor takes over the administration of a company's receivables (= money owed by suppliers). The factor pays the business the money that suppliers owe to it immediately, in return for a percentage.
intangible assets non-physical assets, such as brand names, patents and customer lists.
inventories stocks, such as raw materials and finished goods held by a business.
liabilities money owed by the business to banks and suppliers, for example.
liquidity the ease with which assets can be converted into cash.
net assets total assets – total liabilities.
non-current assets long-term resources that will be used by the business repeatedly over a period of time.
non-current liabilities money owed by the business for more than 1 year, sometimes called long-term liabilities.
shareholders' equity the amount of money owed by the business to the shareholders.
statement of financial position (balance sheet) a summary at a particular point in time of the value of a firm's assets, liabilities and capital.
trade and other payables money owed by the business to suppliers and utilities, for example. Sometimes called trade creditors.
trade and other receivables money owed to the business by customers and any prepayments made by the business.
working capital the funds left over to meet day-to-day expenses after current debts have been paid. It is calculated by subtracting current liabilities from current assets.

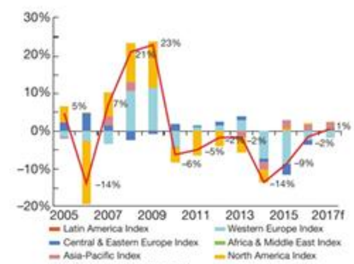
Chapter 36 – Business failure

GLOBAL BUSINESS FAILURE

Every year hundreds of thousands of businesses are set up around the world. However, at the same time thousands of existing businesses also collapse. One measure of business failure, the global insolvency index, is shown for the period from 2005 to 2017 in Figure 2. The graph shows that the insolvency index rose quite sharply in 2008, peaking in 2009 at around 23 per cent. This increase in the rate of business failure was caused by the financial crisis at the time, which resulted in economic recession in many parts of the world.

INTERNAL CAUSES OF BUSINESS FAILURE

Businesses fail for a wide variety of reasons. In some cases, the cause of failure comes from within the business, for example, through ineffective management.



▲ Figure 2 D&B global insolvency rate
Source: National Statistics offices. D&B

Global Insolvency Data for Q1 2012

	D&B Global Insolvency Index	Year on year change (%) Q1 12	yr to Q1
World	90.2	–5.8	–3.8
Advanced economies	88.3	–8.3	–4.8
North America	75.0	–17.5	–13.9
Euroland	103.7	–1.9	2.6
Nordic Region	94.6	–6.2	–5.3
Emerging economies (ex. China)	105.5	14.7	4.8
Emerging Asia (ex. China)	103.2	2.3	–4.1
Eastern Europe	118.2	35.4	9.8

Some of the common internal factors that cause business failure are outlined below.

Poor management of cash: Many businesses fail because they run out of cash. In some cases entrepreneurs focus too much on profit and neglect the importance of cash. There is a number of reasons why a business runs short of cash.

• Investing too much in fixed assets. In the initial stages of a business, funds are limited. Spending large amounts quickly on equipment, vehicles and other capital items uses up resources. It may be better to lease some of these fixed assets, leaving sufficient cash funds.

• Allowing too much credit. A great deal of business is done on credit. One of the dangers is that businesses allow their customers too long for payment. This means they have to wait for money and may be forced to borrow during this period. Failure to control debtors may also lead to bad debts. Overborrowing. Businesses may borrow to finance growth. As more loans are taken out, interest costs can rise.

• Seasonal factors. Sometimes trade fluctuates for seasonal reasons. In the agriculture industry, cereal farmers and fruit growers, for example, have a large cash inflow when their harvest is sold. For much of the year, though, they have to pay expenses without any cash flowing in. This situation requires careful management, although it is possible to predict these changes.

• Unforeseen expenditure. Businesses need to prepare for unforeseen expenditure. Equipment breakdowns, tax demands, strikes and bad debts are common examples of this type of emergency expense. In the early stages of business development, owners are often hit by unforeseen expenditure. This might be because they lack experience or have not undertaken sufficient planning.

• External factors. Sometimes events that are outside the control of the business cause cash flow problems. Examples include changes in consumer tastes, changes in legislation or a downturn in the economy. These are discussed in more detail later in this chapter.

• Poor financial management. Inexperience in managing cash or a poor understanding of the way cash flows into and out of a business may lead to cash flow problems. For example, if a business plans to spend heavily just before they receive large amounts of cash from customers that have bought on credit, it is likely to face problems. It is not advisable to spend cash when it is not definitely there. The control of cash flow will be improved if owners and managers produce regular cash flow forecasts, keep up-to-date financial records and operate an efficient credit control system.

Overestimating sales: Forecasting future sales is a very difficult process. This was explained in Chapter 30. For example, consumer tastes and preferences can change dramatically in short periods of time. There is also a large amount of data relating to consumer behaviour and other sales factors, which is sometimes difficult to analyse effectively even with modern analytical techniques.

Overtrading: Young and rapidly growing businesses are particularly prone to overtrading. Overtrading occurs when a business is attempting to fund a large volume of production with inadequate cash. Established companies trying to expand too quickly can also face this problem. Overtrading is most likely to occur if customers are given generous credit terms, if the business is undercapitalised or if profit margins are very slim.

Poor inventory control: Ineffective inventory control can cause problems for businesses. Poor inventory control may mean a business is holding too much stock, too little stock or the wrong sort of stock. If a business carries large quantities of inventory, money is tied up in unproductive assets. Inventories do not generate any return for a business until they are sold.

If the wrong sort of stock is bought by a business this could cause serious problems.

If a business has too little stock it runs the risk of losing business.

Poor marketing: A range of marketing problems could be the cause of business failure. Businesses that launch new products that fail to meet customer needs are likely to have difficulties. The use of inappropriate pricing strategies could mean that prices are too high or too low. A business may invest too heavily in wasteful or inappropriate promotional campaigns.

Poor quality: Supplying products which fail to meet customer quality expectations is likely to cause difficulties for businesses. Poor-quality products can result in lost customers and long-term damage to the reputation of a business.

EXTERNAL CAUSES OF BUSINESS FAILURE

It could be argued that failed business owners are quick to blame external factors for the problems their business faced - thereby taking blame away from themselves. However, it is reckoned by some that only about 20 per cent of business failure is due to external forces. Some of the most likely external factors to cause business failure are outlined below.

Market conditions: Markets are dynamic, which means they change all the time. For example, consumer tastes are not constant and businesses that cannot adapt to changes are more likely to fail. In the last 10 years or so there has been a huge growth in online shopping. Retailers that have failed to set up their own online operation have often struggled. Also, over time certain industries decline and are replaced by others.

Competition: The strength and success of business rivals can be a cause of failure. Competitors might bring out superior products. They might read market conditions more effectively. They may charge lower prices because their costs are lower. They may be a powerful company and use predatory pricing to drive smaller rivals out of the market. In recent years many manufacturers in the west have been outcompeted by low-cost producers from China and other emerging nations. Many high street retailers have collapsed because people are doing more of their shopping online where the same products are often cheaper.

Economic: The general state of the economy, both domestic and global, can have an impact on the success of businesses. Figure 2 shows that the level of business failures rose after the financial crisis in 2008. After this crisis many countries in the world went into recession and thousands of businesses in many countries collapsed as a result. The government's economic policies might also contribute to business failure.

Exchange rates: Businesses that import and export will be affected by changes in the exchange rate. This could reduce demand and force marginal firms into administration. In 2017, the Egyptian pound fell sharply after it was devalued by the government. This meant that many businesses that had borrowed money from abroad faced a huge increase in fees and interest charges.

Interest rates: In many countries interest rates have been historically low since the mid-2000s. However, a sharp increase in rates could cause difficulties for some businesses. Those with large debts would be at risk, as would those that depend on consumers using credit to fund their purchasing. Rising debt often causes problems for businesses and when interest rates rise the burden of that debt may 'crush' a company.

Government regulations: Sometimes changes in government legislation can lead to business failure. For example, in 2014 a number of moneylenders withdrew from the market in the UK after the government passed legislation to control the supply of so-called 'payday loans'.

Supplier problems: It is possible for a business to collapse if they are let down by suppliers. For example, if a key supplier fails to make deliveries, a business may not be able to meet customer orders. As a result customers might go to rivals and never return.

Natural phenomena: Some businesses can fail due to natural occurrences such as the weather.

SUBJECT VOCABULARY

administration where a failing business appoints a specialist to rescue the business or wind it up.
bushel customary unit of weight or mass. Historically equal to 8 gallons (35 litres). Modern use: equal to a mass defined differently for each commodity.
external factors factors beyond the control of businesses, which can cause collapse.
internal factors factors that businesses are able to control, which can cause collapse.
overtrading a situation where a business does not have enough cash to support its production and sales, usually because it is growing too fast.

Revision questions