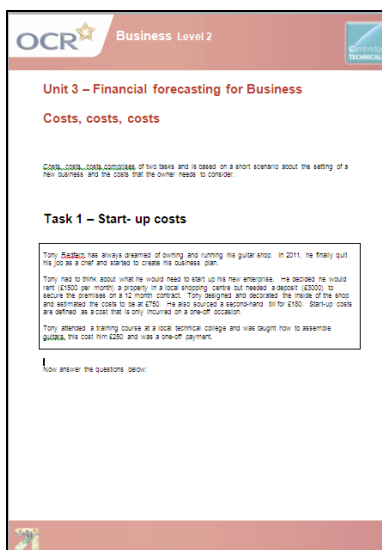


Unit 3 – Financial forecasting for Business

Costs, costs, costs

Instructions and answers for Teachers

These instructions should accompany the OCR resource 'Costs, costs, costs', which supports OCR Level 2 Cambridge Technical Certificate in Business Unit 3 – Financial forecasting for Business



OCR Business Level 2 Cambridge TECHNICALS

Unit 3 – Financial forecasting for Business

Costs, costs, costs

Costs, costs, costs comprises of two tasks and is based on a short scenario about the setting of a new business and the costs that the owner needs to consider.

Task 1 – Start-up costs

Tony Redfern has always dreamed of owning and running his guitar shop. In 2011, he finally quit his job as a chef and started to create his business plan.

Tony had to think about what he would need to start up his new enterprise. He decided he would rent (£1500 per month) a property in a local shopping centre but needed a deposit (£3000) to secure the premises on a 12 month contract. Tony designed and decorated the inside of the shop and estimated the costs to be at £750. He also sourced a second-hand till for £180. Start-up costs are defined as a cost that is only incurred on a one-off occasion.

Tony attended a training course at a local technical college and was taught how to assemble guitars, this cost him £250 and was a one-off payment.

Now answer the questions below.

Associated Files:
Costs, costs, costs

Expected Duration:
Task 1 approx 30 minutes
Task 2 approx 30 minutes

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Task 1 – Start-up costs

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Now answer the questions below:
(Sample answers below)

1	What are Tony's start-up costs?	Deposit – £3000 Decoration – £750 Till – £180 Training course – £250		
2	How much money will Tony need to start trading?	Deposit – £3000 Decoration – £750 Till – £180 One month's rent – £1500 £5430		
3	Has Tony forgotten about any costs which you think he should include?	For example: Insurance Stock Launch Advertising		
4	Why is it important that Tony plans how much money he will need to set up his business?	For example: Tony can forecast and plan how he is going to finance his business operation. He may take his plan to banks and other financial institutions to show what he wants to spend their investment on. This will give Tony a better chance of being awarded that important first investment.		
5	Where could Tony get the capital he needs to set up his shop?	For example: Friends/family Bank/finance company loan Government grants		
6	What would be advantages and disadvantages of Tony getting the capital he needs from the different sources you have identified?	For example:		
		Source	Advantages	Disadvantages
		Friends/family	Money can be paid back at a time agreed by both parties. Little or no interest could be paid on the loan.	Limited amount of capital can be raised. No other financial products can be offered, eg overdrafts.
		Bank/finance company loan	Can request to be lent high amounts of capital. Other financial products can be offered. Business advice and support can be given.	Interest has to be paid on the loans. Strict deadlines have to be met or the bank may claim some of Tony's possessions.
		Government grants	Usually interest free. Government may be understanding towards late repayments.	Not available in all areas. Application process can be lengthy.



Task 2 – Operating costs

Tony's guitar shop is now ready to open but he is concerned about how much it is going to cost him to run and operate the business.

Tony buys the guitars in three pieces (his raw materials) and employs a part-time member of staff (Pete) three days per week to assemble the instruments. Tony pays Pete on a piece rate (per guitar Pete produces) of £5 per complete guitar.

The guitars have a main body, a neck and electronic pickups which are fitted together. Each unassembled guitar costs Tony £25 to import from Taiwan. Tony's premises cost £1500 per month. Tony has a monthly electrical charge of £52 per month. Tony also has a telephone and broadband contract which is £45 per month.

Variable costs are costs incurred by a business which change with the level of output or products made. On the other hand, fixed costs do not change with the level of output or produce made.

Now answers the questions below:
(Sample answers below)

1	How much does it cost to make one guitar?	£30 (£25 for raw materials and £5 to Pete per guitar)
2	If Pete makes 20 guitars in a month, how much would that cost Tony altogether?	£600 (20 guitars x £30)
3	If Pete makes 60 guitars in a month, how much would that cost Tony altogether?	£1800 (60 guitars x £30)
4	Why are the costs coming from the manufacturing of guitars variable costs?	For example: The costs incurred from the making of guitars are variable costs because they change with the level of output. This can be seen in previous two questions – if they produce more guitars then the variable costs increase, in this case from £600 to £1800.
5	Apart from making the guitars, what other costs does Tony's business incur?	Rent – £1500 per month Electricity – £52 per month Telephone and broadband – £45 per month
6	Why are costs you have identified in question 5, fixed?	For example: The costs identified in question 5 are fixed because they do not change with the level of output. They are indirect costs and cannot be associated to a certain product. Tony's rent, electricity and telephone charges will be the same whether he made 20 guitars or 60 guitars therefore making them fixed costs.



These activities offer an opportunity for maths skills development.

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