DP IB Business Management: HL

Your notes

3.1 Introduction to Finance

Contents

Role of Finance for Businesses

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The Importance of Finance

- When **starting a new business** entrepreneurs need finance to **cover initial setup costs**
  - This may include acquiring equipment, renting or purchasing premises, conducting market research, hiring staff and developing a marketing strategy
- Businesses often require finance to fuel their **expansion and growth** plans
  - This could involve opening new locations, entering new markets, launching new products or services, and increasing production capacity

Diagram: why businesses need finance

Reasons why businesses need finance

Capital expenditure

- Businesses require finance for **capital expenditure** such as purchasing machinery, technology, vehicles, and infrastructure
  - These investments enable businesses to enhance productivity, expand operations and improve efficiency

Working capital

- **Working Capital** is necessary to manage the **day-to-day operations of a business**

- It helps cover expenses such as p**urchasing inventory**, paying suppliers, **meeting payroll obligations** and funding overhead costs like rent and utilities
- Sufficient working capital ensures that a business can **operate smoothly without facing cash flow issues**

Research & development

- Businesses require finance for **research and development** (R&D)
    - Money is needed to invest in technical research and product development
    - This investment helps them stay ahead of the competition and create **new revenue streams**

Marketing

- Effective **marketing and advertising** require finance to develop and execute marketing campaigns, create advertising materials, conduct market research and build brand awareness
    - Investing in marketing helps attract customers, increase sales, and generate revenue

Risk management

- Businesses need finance to **manage risks** and protect against unforeseen events
    - This includes paying for insurance coverage, contingency funds and implementing risk management strategies

Debt servicing

- Many businesses need to **service debts,** such as loans or credit facilities
    - These debts, including interest, must be repaid over the agreed-upon period

Business performance

- Finance provides a metric to **measure business performance**
- Business success is often judged by the level of profits it makes and the stability of a business can be determined by the level of working capital or liquid assets available

Capital Expenditure

- Capital expenditure is business **spending on non-current assets**
    - These are assets which will be **used many times** and **for more than one year**
- Common examples of non current assets for which capital expenditure is required include

Diagram: capital expenditure

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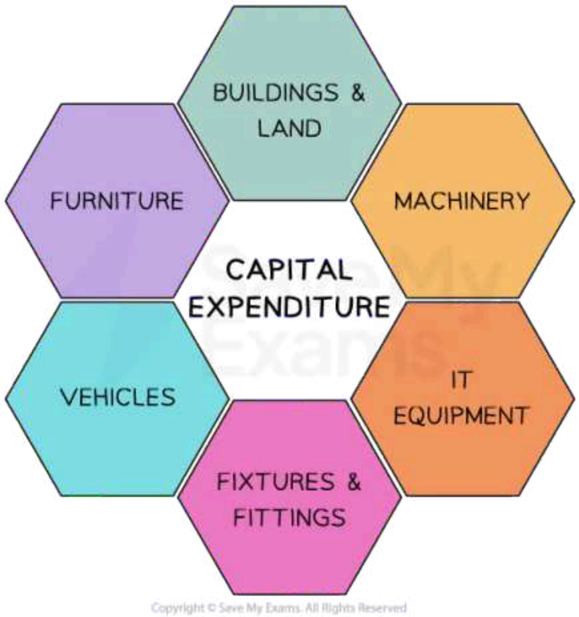

Examples of current assets for which capital expenditure is required

Revenue Expenditure

- **Revenue expenditure** is spending on goods and services that a business **uses in the short-term** as part of its **normal trading activities**
- Common examples of **current assets** for which revenue expenditure is required include

Diagram: revenue expenditure

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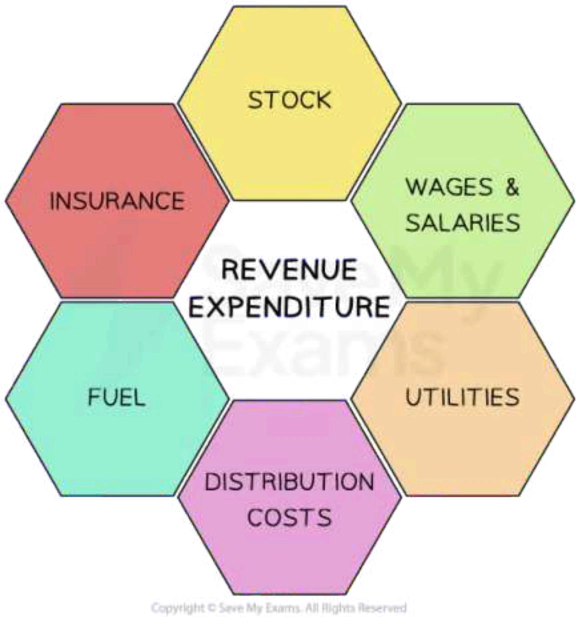

Examples of day to day costs for which revenue expenditure is required