

DP IB Business Management: HL



Your notes

3.3 Costs & Revenues

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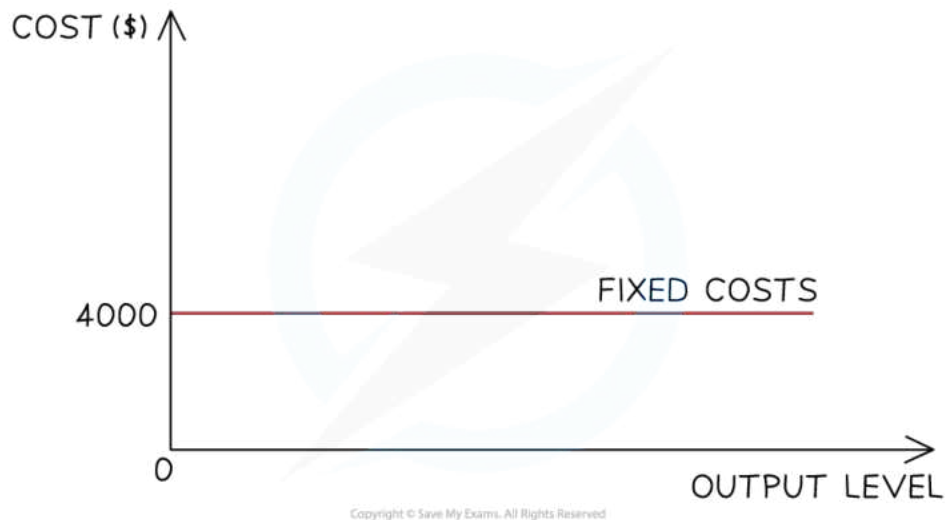
Types of Costs

An Introduction to Costs

- In preparing goods and services for sale, businesses **incur a range of costs**
 - Some examples of these these costs include **purchasing raw materials**, paying staff salaries and wages, and **paying utility bills** such as electricity
- These costs can be broken into different categories
 - **Fixed costs (FC)** are costs that do not change as the level of output changes
 - These have to be paid whether the output is zero or 5000
 - **Variable costs (VC)** are costs that vary directly with the output
 - These increase as output increases & vice versa
 - **Total costs (TC)** are the sum of the fixed + variable costs

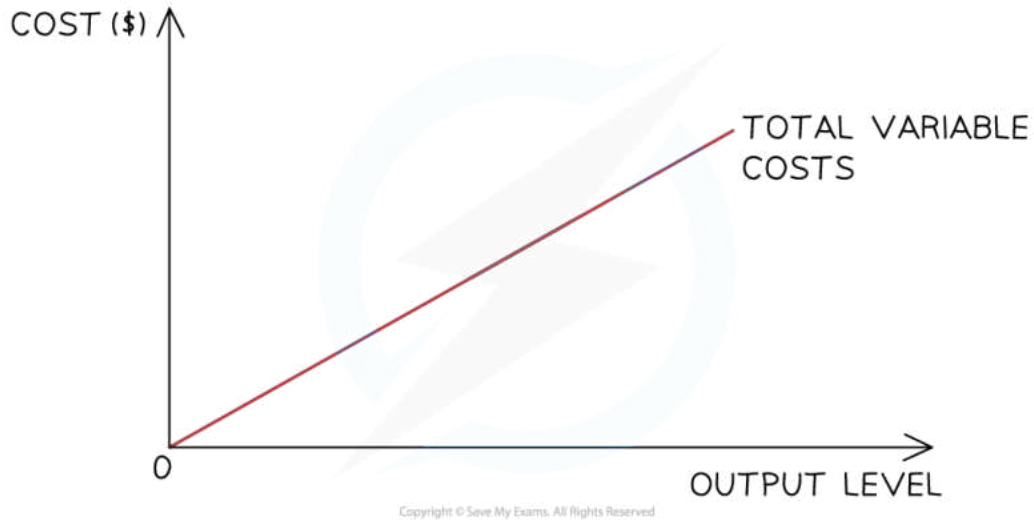
Comparison of the Types of Cost

Fixed costs (FC)



- The firm has to pay its **fixed costs** which do not change, irrespective if the output is 0 or 100,000 units
- The fixed costs for this firm are \$4,000

Variable costs (VC)



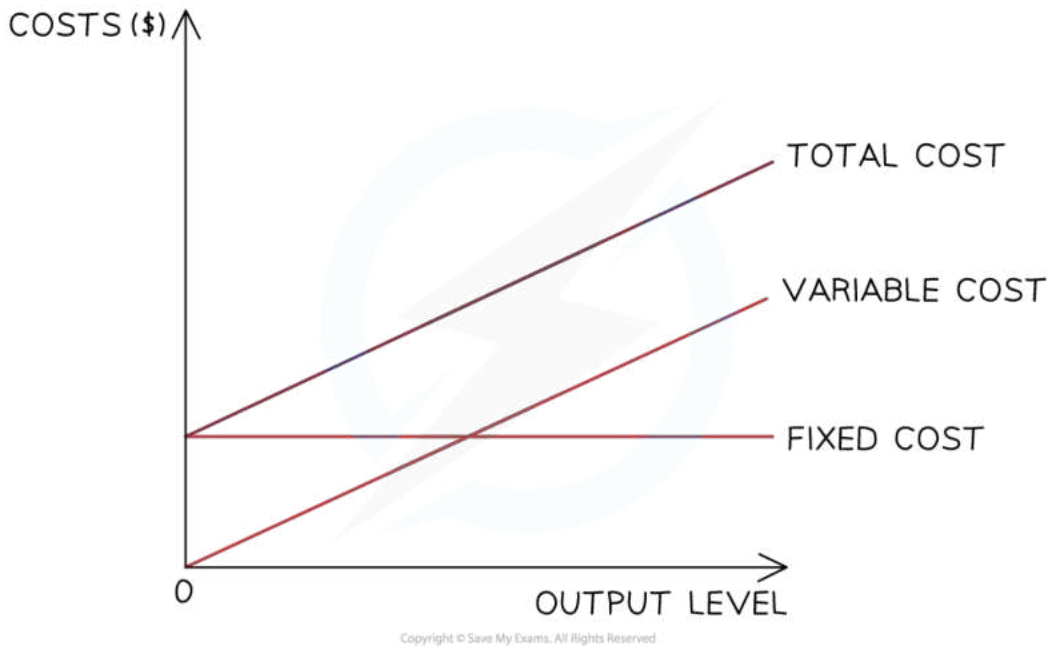
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- The variable costs initially **rise proportionally with output**, as shown in the diagram
- At some point, the firm will benefit from a **purchasing economy of scale** and the rise will no longer be proportional

Total costs (TC)



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- The **total cost** is the sum of the variable and fixed costs
- The total costs **cannot be 0** as all firms have some level of fixed costs

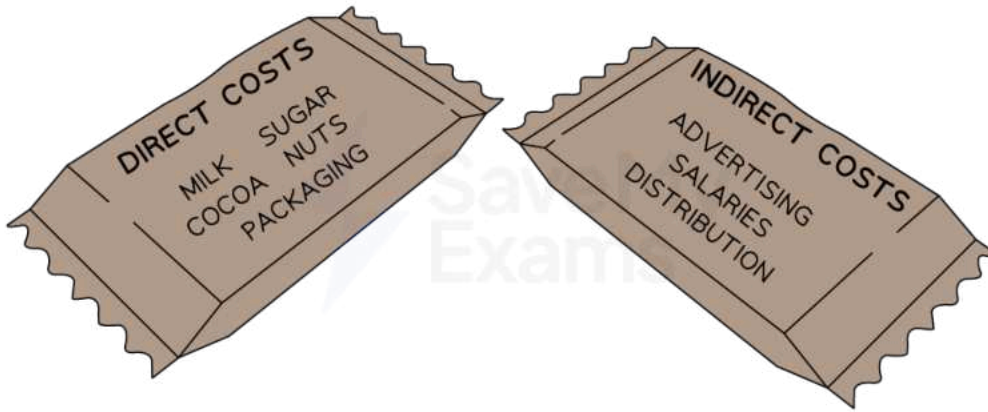
Direct & Indirect Costs

- Direct costs are related to the production of a particular product and **vary directly with output**
 - Examples include raw materials, components and packaging
- Indirect costs cannot be allocated easily to the production of a particular product
 - They **relate to the business as a whole** and are often called **overheads**
 - Examples include administration costs, salaries and rental fees

Diagram: direct and indirect Costs



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Examples of direct and indirect costs for a chocolate manufacturer



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Sales Revenue

Revenue & Revenue Streams

- Sales Revenue is the **value of the units** sold by a business over a period of time
 - E.g the revenue earned by Apple Music from sales of music downloads
 - Sales revenue is a **key business performance measure** and must be calculated to identify profit
 - Sales revenue is calculated using the formula

$$\text{Sales revenue} = \text{quantity sold} \times \text{selling price}$$

- Sales revenue **usually increases** as the **sales volume increases**
- When a firm sells one product it is easy to calculate the sales revenue
 - The more products a firm sells, the harder it is to calculate the sales revenue
 - **Computer systems** make it easier to track sales revenue when multiple products are sold by the business



Worked Example

Fotherhill Organics Limited sold 39,264 packs of its specialist compost to mail-order customers in 2022. The price per pack was £8.75. In addition, it sold 4,275 tonnes to gardening businesses for £123.95 per tonne.

Calculate Fotherhill Organics sales revenue for 2022? [3 marks]

Answer:

Step 1 – Calculate the sales revenue from sales to mail-order customers

$$39,264 \times £8.75 = £343,560 \quad [1]$$

Step 2 – Calculate the sales revenue from sales to gardening businesses

$$4,280 \times £123.95 = £530,506 \quad [1]$$

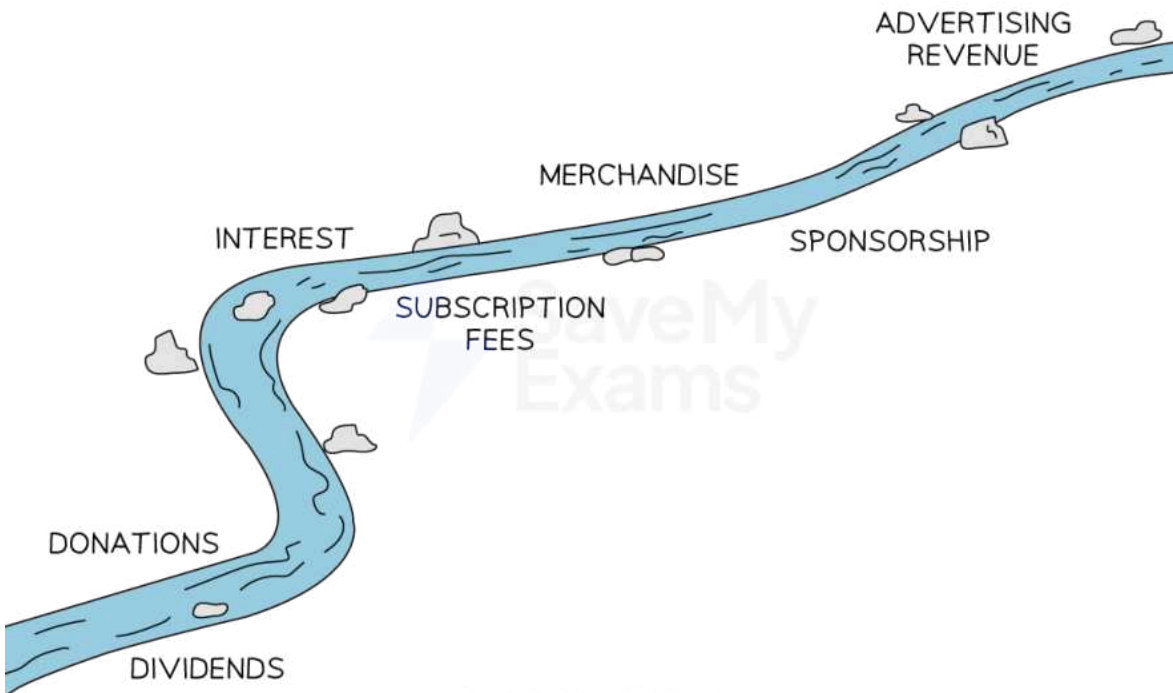
Step 3 – Add together the two sales revenue figures

$$£343,560 + £530,506 = £874,066 \quad [1]$$

Revenue streams

- Revenue can be generated from sources other than sales
- These sources are called **revenue streams**

Diagram: revenue streams



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Some examples of revenue streams for businesses

An Explanation of Revenue Streams

Revenue Stream	Explanation	Example
Dividends	<ul style="list-style-type: none"> Businesses sometimes purchase shares in other companies and may be entitled to dividends 	<ul style="list-style-type: none"> The UK's leading supermarket Tesco received more than £68m in dividends in 2023 from its investments in a range of property companies



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	<ul style="list-style-type: none"> For holding companies, dividends are the primary source of revenue 	
Donations	<ul style="list-style-type: none"> An important source of revenue for not-for-profit organisations such as charities 	<ul style="list-style-type: none"> In 2022 Oxfam received over £70m of revenue in the form of donations and legacies
Interest	<ul style="list-style-type: none"> Many businesses hold substantial amounts of cash as bank deposits which earn interest 	<ul style="list-style-type: none"> Clothing retailer Zara's parent company Inditex earned £85m net interest revenue in 2022
Subscription fees	<ul style="list-style-type: none"> Some businesses earn the majority of their revenue from subscriptions that allow users to access a product or service for a regular ongoing fee Subscriptions are also frequently offered alongside one-off purchases 	<ul style="list-style-type: none"> In 2022 Netflix earned \$31.6 billion in subscription revenue in 2022, 40% of which was generated in North America, its largest market
Merchandise	<ul style="list-style-type: none"> Merchandise is a useful way to earn additional revenue alongside core sales of a product or service 	<ul style="list-style-type: none"> As well as revenue earned from the sale of broadcasting rights and ticket sales, official merchandise sales during 2016's Rio de Janeiro Olympics reached \$15.5 million
Sponsorship	<ul style="list-style-type: none"> Some organisations attract sponsorship from businesses that are keen to associate themselves with the brand 	<ul style="list-style-type: none"> In 2022 FC Barcelona received more than \$215 million of sponsorship revenue from 35 worldwide sponsors including Nike, Coca Cola and Allianz Bank
Advertising Revenue	<ul style="list-style-type: none"> Online media businesses - in particular social media - generate the majority of their revenue from advertising 	<ul style="list-style-type: none"> In 2022 social media giant Twitter earned \$4.14 billion in advertising revenue