



# HL IB Business Management



Your notes

## 3.3 Costs & Revenues

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## Types of Costs

### An Introduction to Costs

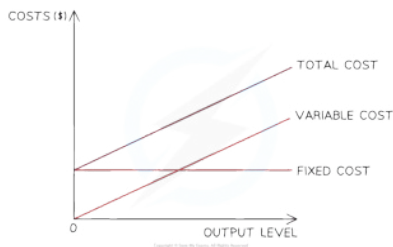
- In preparing goods/services for sale, businesses **incur a range of costs**
  - Some examples of these these costs include **purchasing raw materials**, paying staff salaries and wages, and **paying utility bills** such as electricity
- These costs can be broken into different categories
  - **Fixed 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
    - E.g. building rent, management salaries, insurance, bank loan repayments etc.
  - **Variable costs (VC)** are costs that vary directly with the output
    - These increase as output increases & vice versa
    - E.g. raw material costs, wages of workers directly involved in the production
- **Total costs (TC)** are the sum of the fixed + variable costs

#### Sketches Which Represent the Different Types of Cost

Type of Cost	Diagram	Explanation
Fixed Cost (FC)	<p>The diagram shows a coordinate system with 'COST (\$)' on the vertical axis and 'OUTPUT LEVEL' on the horizontal axis. A horizontal red line is drawn at the value 4000 on the y-axis, labeled 'FIXED COSTS'. The origin is marked with '0'.</p>	<ul style="list-style-type: none"> <li>▪ The firm has to pay its fixed costs which do not change, irrespective if the output is 0 or 100,000 units</li> <li>▪ The fixed costs for this firm are \$4,000</li> </ul>
Variable Cost (VC)	<p>The diagram shows a coordinate system with 'COST (\$)' on the vertical axis and 'OUTPUT LEVEL' on the horizontal axis. A straight red line starts at the origin (0,0) and slopes upwards, labeled 'TOTAL VARIABLE COSTS'. The origin is marked with '0'.</p>	<ul style="list-style-type: none"> <li>▪ The variable costs initially <b>rise proportionally with output</b>, as shown in the diagram</li> <li>▪ At some point, the firm will benefit from a purchasing economy of scale and the rise will no longer be proportional</li> </ul>
Total Cost (TC)		<ul style="list-style-type: none"> <li>▪ The <b>total cost</b> is the sum of the variable and fixed costs</li> </ul>



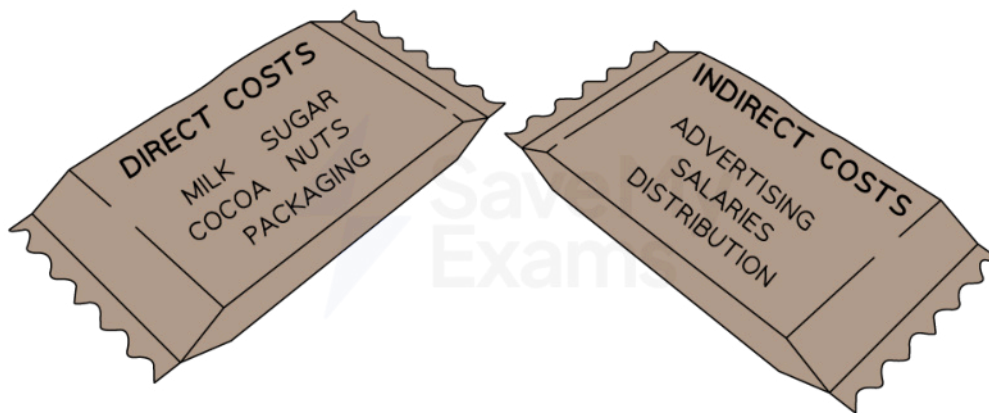
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- The total costs **cannot be 0** as all firms have some level of fixed costs

## Direct & Indirect Costs

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



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### Examples of direct and indirect costs for a chocolate manufacturer

#### Examiner Tip

The terms direct costs and variable costs are often used interchangeably. Whilst this is generally acceptable, you should use variable costs when calculating or discussing break even and use the term direct costs at all other times

Similarly, reserve fixed costs for break even and use indirect costs at all other times



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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]

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

$$39,264 \times £8.75 = £343,560 \quad [1 \text{ mark}]$$

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

$$4,280 \times £123.95 = £530,506 \quad [1 \text{ mark}]$$

#### Step 3 – Add the two sales revenue figures together

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

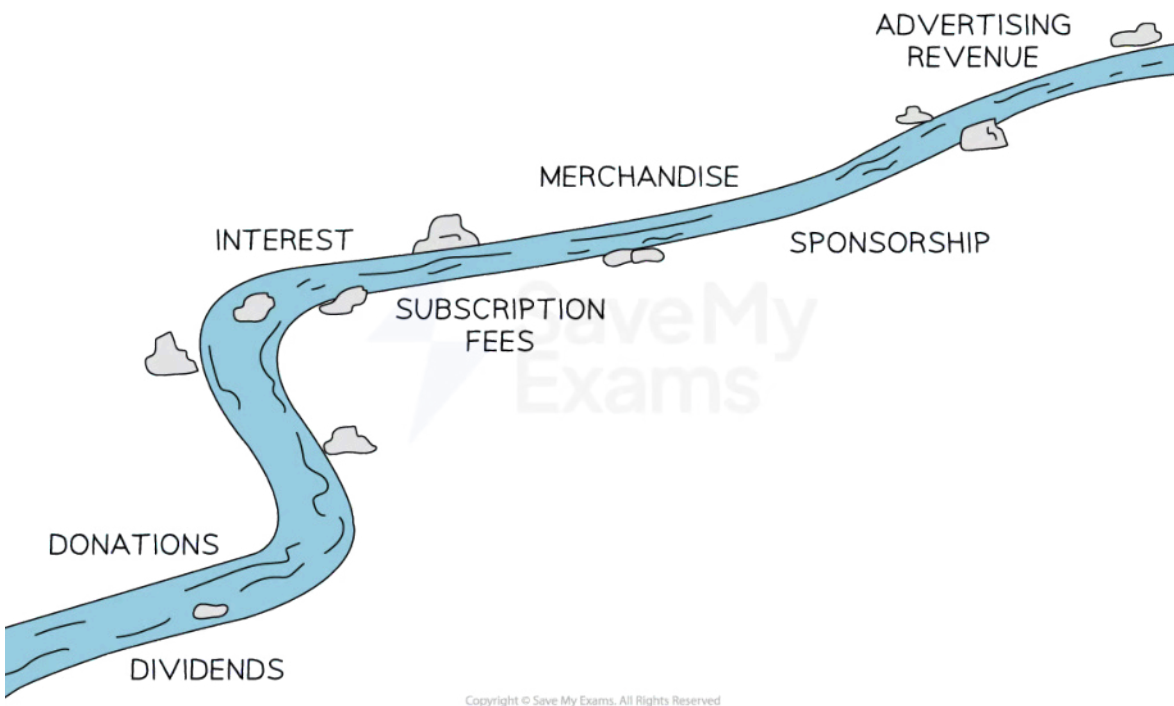
 **Examiner Tip**

You may be required to calculate the average selling price using the sales revenue figure  
In these instances you need to divide the sales revenue by the number of items sold



Your notes

**Revenue Streams**



*Some examples of revenue streams for businesses*

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

**An Explanation of Different Revenue Streams Businesses can Generate**

Revenue Stream	Explanation	Example
Dividends		



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	<ul style="list-style-type: none"> <li>Businesses sometimes <b>purchase shares in other companies</b> and may be entitled to dividends</li> <li>For holding companies dividends are the primary source of revenue</li> </ul>	<ul style="list-style-type: none"> <li>The UK's leading supermarket Tesco received more than <b>£68m in dividends in 2023</b> from its investments in a range of property companies</li> </ul>
<b>Donations</b>	<ul style="list-style-type: none"> <li>An important source of revenue for not-for-profit organisations such as <b>charities</b></li> </ul>	<ul style="list-style-type: none"> <li>In 2022 Oxfam received <b>over £70m of revenue in the form of donations</b> and legacies</li> </ul>
<b>Interest</b>	<ul style="list-style-type: none"> <li>Many businesses hold substantial amounts of cash as <b>bank deposits which earn interest</b></li> </ul>	<ul style="list-style-type: none"> <li>Clothing retailer Zara's parent company Inditex earned £85m net interest revenue in 2022</li> </ul>
<b>Subscription fees</b>	<ul style="list-style-type: none"> <li>Some businesses earn the majority of their revenue from subscriptions that <b>allow users to access a product or service for a regular ongoing fee</b></li> <li>Subscriptions are also frequently offered alongside one-off purchases</li> </ul>	<ul style="list-style-type: none"> <li>In 2022 Netflix earned \$31.6 billion in subscription revenue in 2022, 40% of which was generated in North America, its largest market</li> </ul>
<b>Merchandise</b>	<ul style="list-style-type: none"> <li>Merchandise is a useful way to earn <b>additional revenue alongside core sales</b> of a product or service</li> </ul>	<ul style="list-style-type: none"> <li>As well as revenue earned from the <b>sale of broadcasting rights and ticket sales, official merchandise sales</b> during 2016's Rio de Janeiro Olympics reached \$15.5 million</li> </ul>
<b>Sponsorship</b>	<ul style="list-style-type: none"> <li>Some organisations attract sponsorship from businesses that are keen to <b>associate themselves with the brand</b></li> </ul>	<ul style="list-style-type: none"> <li>In 2022 FC Barcelona received more than \$215 million of <b>sponsorship revenue from 35 worldwide sponsors</b> including Nike, Coca Cola and Allianz Bank</li> </ul>
<b>Advertising Revenue</b>	<ul style="list-style-type: none"> <li>Online media businesses - in particular social media - generate the majority of their <b>revenue from advertising</b></li> </ul>	<ul style="list-style-type: none"> <li>In 2022 social media giant Twitter earned \$4.14 billion in advertising revenue</li> </ul>