B

Plan small business finances

Learner Guide

Table of Contents

1. Identify costs, calculate prices and prepare profit statement

1.1 – Identify and document costs associated with production and delivery of the business products/services

Costs may include:

- Direct/indirect costs
- Fixed, variable, semi-variable costs
- Overheads and employee costs

The management of accounting is a far more dynamic process than Financial Accounting.

For a small business operator it is the process of:

- Identifying, extracting and interpreting key information in the accounts and financial statements.

Obviously financial accounting is a necessity and in most cases supported in application and assessment by an internal or external accountant.

- Sound management accounting is fundamental to successful financial management of the small business as it is pointless being able to read financial statements without being able to interpret them.
- The days of the only people being able to interpret the financial statements and key financial data being the Accountant, Financial Controller, Finance Manager etc are well and truly over.
- The small business owner must be able to interpret the financial data if not in a detailed sense then at least broadly.
- Remember, you are running a business and you don't have to possess a finance background or have had formal commercial training to be able to interpret the financial data.

Identify and document costs

Direct Costs

- Direct costs are costs that can be easily traced to a particular object such as a product, the raw materials used to manufacture a product, or the labour associated with the work to produce the product.

- If your small business produces a widget and a production manager is hired to oversee production of that widget, then the production manager's salary is a direct cost.

- If you own a small business e.g., a carpet cleaning business, which is a service organisation, and you hire employees just to clean carpets, their wages are direct costs.

Direct material costs

Those materials which satisfy the following characteristics:

- They can be identified with the finished product

- They vary directly with the volume of output

- They form part and parcel of the finished product

- They can be measured in terms of production units

- They are quite significant in amount and constitute a major portion of the total cost

Direct costs are often, but not always, variable costs.

How to identify direct material cost

- The cost of all materials specifically purchased for a particular process, job is considered as direct material cost

- Packing materials, e.g. cardboard, boxes, cartons, etc. are also treated as direct material cost

- costs incurred for transporting the materials and making it ready for consumption are also the part of direct material cost

- Steel in manufacturing cars

- Timber in manufacturing furniture

- Fruits in manufacturing jams

- Polythene in manufacturing plastic product

Indirect materials

Indirect material costs

- Materials are said to se indirect when a direct relationship cannot be established between materials used with the units produced.

- They cannot be easily identified with finished goods. Indirect materials are ancillary to production. Indirect materials cost is considered as part of overheads.

Materials such as tools, cleaning supplies, and office supplies make production of a company's products possible but can't be assigned to just one product.

Indirect materials costs are usually variable because materials are based on the level of production.

- These costs must be incurred and paid in order to generate a growing revenue stream, nurture innovation, develop the infrastructure needed to execute projects and strategies, and administer the activities of the business.

Indirect labour

Costs that make production of a product or products possible but can't be assigned to one particular product are classified as indirect costs.

Example of an indirect labour cost:

- The salary of a manager as that manager would manage the entire operation and not just one product.

Fixed or variable

In this case, if the salary is a monthly or annual salary and does not change based on production, it is a fixed cost.

If it is based on production, it is a variable cost.

Variable costs increase as more units of the product are manufactured. As a result, raw materials are variable and direct costs. But, if there is a supervisor overseeing the manufacturing of this particular product, their salary is probably the same regardless of how much of the product is manufactured, so it is a fixed cost.

Variable cost movement

- Variable costs are directly related to sales.

- Variable costs change with sales. As sales go up, so do variable costs. As sales go down, variable costs go down.

- Variable costs are costs of labour or materials that change with sales.

- One way for a company to save money is to reduce its variable costs.

- Sometimes, calculating variable costs is as simple as looking at your costs of goods sold on your income statement.

Semi-variable costs

- Some costs have components that are fixed and some that are variable.
- One example is wages for a sales force.
- A portion of the wage for a salesperson may be a fixed salary and the rest may be sales commission.
- When calculating your fixed and variable costs, you should allocate the fixed portion to fixed costs and the variable portion to variable costs.

Overheads

- In small business, overhead expense refers to an ongoing expense of operating a business (also known as Operating Expenses – rent, electricity, wages, insurance, etc.)
- The term overhead is usually used to group expenses that are necessary to the continued functioning of the business but cannot be immediately associated with the products/services being offered, i.e., they do not directly generate profits.

Overheads are indirect costs

Examples

- Data and transmitted data used for carrying routing information and error correcting and operational instructions.
- Energy or water lost during delivery from the generating or production plant to the end user

1.2 – Calculate prices based on costs and profit margin, as an hourly charge-out rate for labour or unit price for products

I am a small business manufacturer	Product A costs = \$1,000 I want a 20% profit margin \$1,000 x 20% = \$200 \$1,000 + \$200 = \$1,200. \$1,200 is my selling price for this product
I am a small business Consultant	My labour cost per hour is \$58.00 I want a 40% profit margin

	$58 x 20% = $23.20 $58 + $23.20 = $81.20 $81.20 is my price per hour for this service

- Cost of goods sold (see 1.1)
- Gross profit margin
- Margin and mark-up

The gross profit margin

Gross profit margin refers to the difference between revenue and gross profit.

- If the business is said to have a low margin, such as a grocery store, it means that the cost of sales is high in relationship to revenues.
- The margin, or difference between revenues and cost of sales, is low.
- Businesses with a low margin need to make up for the low margin with a high volume of sales.
- Businesses with a high margin, such as a jewellery store or a high-end clothing store have a low cost of sales compared to revenues.

Knowing the cost of sales for your small business is critical to maximising your profit.

		ABC Co		XYZ Co
Revenue		$3,500,000		$3,500,000
Cost of Sales	49%	$1,715,000	51%	$1,785,000
Gross profit	51%	$1,785,000	49%	$1,715,000
Expenses		$1,350,000		$1,350,000
Net income		$435,000		$365,000

- XYZ Company, with cost of sales 2% higher than ABC Company, makes a $365,000 profit.
- ABC Company, with a 2% lower cost of sales, generates an additional $70,000.00, an increase of 19% in net income.
- Because they pay close attention to their cost of sales, ABC Company has a higher gross profit margin and is substantially more profitable than XYZ Company.

Cost of goods sold and operating expenses are shown in separate sections of the profit and loss report.

First, the statement shows revenues, followed by cost of goods sold. Cost of goods sold is subtracted from revenues to produce gross profit. Expenses are then summarised, totalled, and subtracted from gross profit to calculate net income from operations. Finally, extraordinary items — such as the gain or loss on a sale of fixed assets — are added or subtracted from net operating income to yield net income. The standard format for an income statement is therefore as follows:

Example

Revenue	$250,000	
Less discounts	$15,000	
Total revenues		$235.000
Cost of goods sold		$125,000
Gross profit		**$110,000**

Expenses		
Power	$2,000	
Lighting	$2,500	
Total expenses		$4,500
Net income		**$105,500**

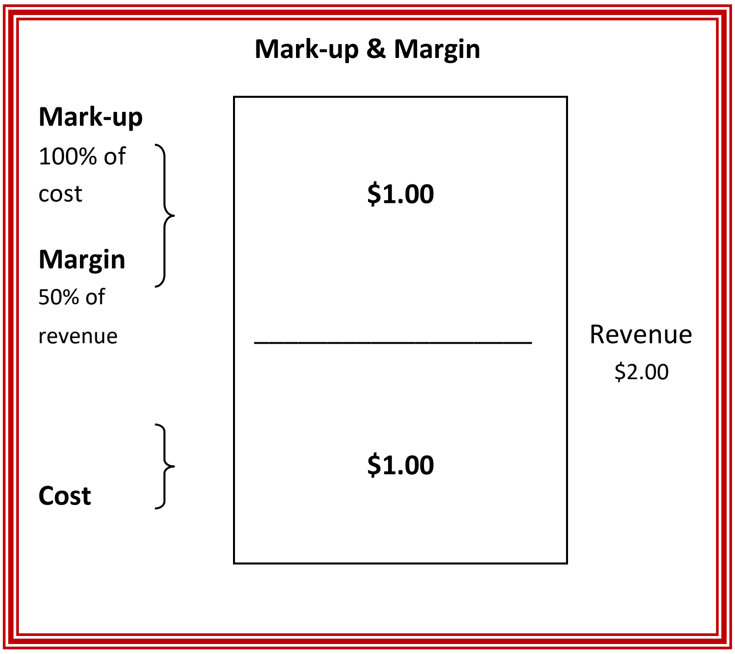
Extraordinary income	**$1,250**
Extraordinary expense	$1,100
Net income	**$105,650**

Extraordinary items — such as the gain or loss on a sale of fixed assets — are added or subtracted from net operating income to produce net income.

The term revenue refers to amounts generated from the sale of goods and services. Cost of goods sold is the direct cost of the items sold. Operating expenses refer to the ordinary and necessary costs — other than direct costs — of running the business. These distinctions are important not only in presenting information in a standard format, but also in analysing business profitability.

Margin and mark-up: two ways of looking at the same thing

- Mark-up is the term with which most retailers are comfortable.
- Mark-up is based on cost. A retailer multiplies a percentage — known as the mark-up — times the cost of a product to calculate the sales price for the product.
- While mark-up and margin refer to the same thing, they're calculated differently.
- Mark-up is based on cost, and margin is based on revenue.
- A 100% mark-up becomes a 50% margin. With a cost of $1.00 and a 100% markup, the mark-up is $1.00 and gross revenue is $2.00.



- The mark-up is 100% of the cost (mark-up of $1.00/Cost of $1.00=100%).
- However, the margin is 50% — the mark-up divided by gross revenue (markup [or gross profit] of $1.00/Revenue of $2.00=50%).
- While mark-up and margin refer to the same thing, mark-up is calculated based on the relationship of gross profit to cost while margin is calculated based on the relationship of gross profit to revenue.

How to use margin and mark-up to become more profitable

- Business owners use mark-up to calculate the sales price for individual goods. Accountants and analysts use the gross profit margin to view the overall profitability of a business.
- Knowing the average gross profit margin for your particular industry will help you to compare your business to other businesses in your area and remain competitive.

- Tracking the changes in your actual gross profit over time will help you to price your products to maximize gross profit and net income.

Charge out rate for labour

1. Decide what income you want
2. How many hours can you realistically charge out?
3. Work out your charge-out rate to cover your income requirements
4. Work out your overheads
5. Add a profit margin

Non accounting considerations will come into play, such as:

- Am I being competitive?
- Do I lower/raise my rates
- What implications to marketing, sales and revenue will effect these decisions?

1.3 – Calculate break-even sales point to establish business viability and profit margins

Calculate break-even sales point

Example A

Fixed expenses	$100,000
Variable expenses	80% of sales
Contribution margin ratio	20% (Sales minus the variable expenses of 80% of sales leaves a remainder of 20% of sales) In other words, after deducting the variable expenses there remain only 20% of every sales dollar to go towards the fixed expenses and profits.
The fixed expenses of $100,000 divided by the contribution margin ratio of 20%	$500,000
This tells you that if the company has sales of approximately $500,000 it will be at the break-even point – the point where sales will be equal to all of the company's expenses.	

Example B using above...

Sales needed	$500,000

variable expenses	80% of sales
variable expenses in dollars will be	$400,000 (80% of $500,000)
contribution margin in dollars	$100,000
The fixed expenses as per above ($100,000 divided by the contribution margin ratio of 20%	$500,000
fixed expenses	$100,000
Net income will be zero!	**$0**

At the heart of break-even point or break-even analysis is the relationship between expenses and revenues.

Facts

- Expenses will change
- Sales will increase or decrease
- Some expenses will increase as sales increase
- Some expenses will not change as sales increase or decrease

Variable expenses increase when sales increase. They also decrease when sales decrease.

Car Service break down

Motor oil	$ 15.00
Oil filter	15.00
Grease, washer fluid	10.00
Supplies	8.00
Clean interior	5.00
Total variable expenses *per car*	$53.00

Other expenses (rent, power, etc.) will not increase when an additional car is serviced

Variable expenses = $53.00

1 car = 106.00

2 cars = 106.00

3 cars = 159.00

10 cars = 530.00

100 = 5,300.00

Fixed Expenses

- Fixed expenses do not increase when sales increase.
- Fixed expenses do not decrease when sales decrease.
- Fixed expenses such as rent will not change when sales increase or decrease

The following items have been identified as fixed expenses. The amount shown is the fixed expense per week:

Labour including payroll taxes and benefits	$2,500
Rent and utilities for the building it uses $	$800
Depreciation, office and professional, training, other	$500
Total fixed expenses per week	**$3,800**

Revenues (or sales)

- The amounts earned from servicing cars.
- Charges one flat fee of $165 for performing the oil change service.
- For $165 the company changes the oil and filter, adds needed fluids, adds air to the tyres, and inspects engine belts, lights/Washers/Horn/Indicator Switch/A.C. Operation
- Inspect Cooling System (Levels/Hoses/Leaks)
- Inspect Exhaust
- Inspect Steering/Suspension/Engine Mounts
- Inspect Brake Pads & Discs Front & Rear
- Inspect Power Steering Hoses (Leaks/Condition)

As the result of its pricing, if 10 cars are serviced its revenues (or sales) is $1,650. If it services 100 cars, its revenues will be $16,500

Sales price	Units sold	Gross sales	Variable costs	Total variable	Fixed costs	Total costs	Result
$165	10	$1,650	$53	$530	$3,800	$4,330	-$2,680
	15	$2,475		$795	$3,800	$4,595	-$2,120
	25	$4,125		$1,325	$3,800	$5,125	-$1,000
	30	$4,950		$1,590	$3,800	$5,390	-$440
	40	$6,600		$2,120	$3,800	$5,920	$680

10% reduction in variable costs plus 10 extra sales...........

Sales price	Units sold	Gross sales	Variable costs	Total variable	Fixed costs	Total costs	Result
$165	10	$1,650	$48	$477	$3,800	$4,277	-$2,627

	15	$2,475		$716	$3,800	$4,516	-$2,041
	25	$4,125		$1,193	$3,800	$4,993	-$868
	30	$4,950		$1,431	$3,800	$5,231	-$281
	40	$6,600		$1,908	$3,800	$5,708	$892
	50	$8,250		$2,385	$3,800	$6,185	$2,065

1.4 – Identify appropriate pricing strategies in relation to market conditions to meet business profit targets

Small business managers should begin identifying appropriate pricing strategies during the development or business planning phase.

Avoid launching products or services that cannot sustain profitable prices in the market

Using the right strategies at this time:

- Will assist in gaining greater profits and increase or defend your market share
- Will play an important role in the product or service longer term success
- The price of a product or service is one of the principal tasks of marketing

Identifying appropriate pricing strategies is generally regarded as how an organisation sets the prices of its products and services based on:

- Costs
- Value
- Demand
- Competition

Identifying appropriate pricing strategies can also refer to how a company uses pricing to achieve its strategic goals.

Just offering a lower price to increase sales volume or higher prices to decrease a backlog may not be the right "strategic" plan for longer term sustainability.

Price selection or setting and strategy tend to overlap and the different policies and strategies are not necessarily mutually exclusive.

Small business managers can begin developing pricing strategies by first determining the organisations pricing goals.

Pricing goals

- We wish to increase short-term and long-term profits
- We wish to stabilise prices
- We wish to increase the cash flow
- We wish to better compete with the competition

Take into account:

- Market conditions
- Fit market conditions
- Consider customers
- Costs
- Competition
- Different market segments

Pricing strategies in relation to market conditions to meet business profit targets encompasses:

- Whether a company is a new entrant into a market or an established firm.
- New entrants sometimes offer products at low cost to attract market share, while those with a market share hold tend to vary their pricing strategies through past experiences. Reactions vary.
- If organisations with a foot hold in the market do not view a new business as a serious threat, they may simply resort to increased advertising aimed at improving their already established customer loyalty
- Incumbent organisations will likely change their in price in efforts to keep the new entrant from stealing away customers.

The following examples explain various ways organisations identify appropriate pricing strategies in relation to market conditions in order to meet business profit targets.

Pricing strategies may include:

Pricing strategies	Advantages	Disadvantages
Cost/volume/profit analysis	Cost + Fixed profit percentage = Selling price. Cost-based pricing involves the determination of all fixed and variable costs associated with a product or service. After the total costs attributable to the product or service have been determined, managers add a desired profit margin to each unit such as a 5 or 10 percent markup. The goal of the cost-oriented approach is to cover all costs incurred in producing or delivering products or services and to achieve a targeted level of profit.	
Value-based pricing	Value-based pricing thinking is that the optimal selling price is a reflection of a product or service's perceived value by customers, not just the company's costs to produce or provide a product or service. The value of a product or service is derived from customer needs, preferences, expectations, and financial resources as well as from competitors' offerings.	Consequently, this approach calls for managers to query customers and research the market to determine how much they value a product or service. In addition, managers must compare their products or services with those of their competitors to identify their value advantages and disadvantages.
Demand-based pricing	Managers adopting demand-based pricing policies are, like value-based pricing, not fully concerned with costs. Instead, they concentrate on the behaviour and characteristics of customers and the quality and characteristics of their products or services. Demand-oriented pricing focuses on the level of demand for a product or service, not on the cost of materials, labour, and so forth.	

Competitor analysis	What pricing strategies are our competitors pursuing and how successful are these strategies? • What are the strengths and weaknesses of your competitors? • How are your competitors likely to respond to any pricing changes to the way you do business? After this step, a company sets it prices higher than, lower than, or on par with the competitors based on the advantages and disadvantages of a company's product or service as well as on the expected response by competitors to the set price.	

New entrants into a market often rely on pricing strategies that allow them to capture market share quickly.

- When there are several competitors in a market, entrants usually use lower pricing to change consumer spending habits and acquire market share.
- To appeal to customers effectively, new entrants generally implement a simple or transparent pricing structure, which enables customers to compare prices easily and understand that the entrants have lower prices than established incumbent companies.

1.5 – Prepare projected profit statement to supplement the business plan

Definition of 'Profit and Loss Statement – P&L'
A financial statement that summarises the income, costs and expenses incurred during a specific period of time – usually a fiscal quarter or year. These records provide information that shows the ability of a company to generate profit by increasing revenue and reducing costs. The P&L statement is also known as a "statement of profit and loss", an "income statement" "profit statement" or an "income and expense statement".

Financial statements

These provide a historical record of the financial performance of the organisation and its current financial position. These statements are historical records as they are prepared after the reporting date in order to ensure that all transactions pertaining to the reporting period are captured and form the basis of accurate financial position.

The financial statements are also used as a key indicator of the performance of the business by comparing the actual figures achieved to budgeted figures (part of the Business Plan)and figures achieved for comparative periods (e.g. last year, last month etc.).

- The key financial statements are of prime concern to management of a small business and to any Boards or Directors or Trusts that may be involved.
- They are also important as they are required for statutory reporting purposes.

Other important statements include:

- Balance Sheet
- Statement of Cash Flows

Example 1 & 2

Profit and Loss Statement

<Company Name>

For the <Month or Year> ending <Month-Day-Year> **Stated in 000s**

Gross margin [L/J]	-
Return on sales [T/J]	-

	Prior Period	Budget	Current Period	Current Period as % of Sales	% Change from Prior Period	% Change from Budget
Sales Revenue						
Product/Service 1				-	-	-
Product/Service 2				-	-	-
Product/Service 3				-	-	-
Product/Service 4				-	-	-
Total Sales Revenue [J]	0	0	0	-	-	-
Cost of Sales						
Product/Service 1				-	-	-
Product/Service 2				-	-	-
Product/Service 3				-	-	-
Product/Service 4				-	-	-
Total Cost of Sales [K]	0	0	0	-	-	-
Gross Profit [L=J-K]	**0**	**0**	**0**	-	-	-
Operating Expenses						
Sales and Marketing						
Advertising				-	-	-
Direct marketing				-	-	-
Other expenses (specify)				-	-	-
Other expenses (specify)				-	-	-
Total Sales and Marketing Expenses [M]	0	0	0	-	-	-
Research and Development						
Technology licenses				-	-	-
Patents				-	-	-
Other expenses (specify)				-	-	-
Other expenses (specify)				-	-	-

Total Research and Development Expenses [N]	0	0	0	-	-	-
General and Administrative						
Wages and salaries				-	-	-
Outside services				-	-	-
Supplies				-	-	-
Meals and entertainment				-	-	-
Rent				-	-	-
Telephone				-	-	-
Utilities				-	-	-
Depreciation				-	-	-
Insurance				-	-	-
Repairs and maintenance				-	-	-
Other expenses (specify)				-	-	-
Other expenses (specify)				-	-	-
Total General and Administrative Expenses [O]	0	0	0	-	-	-
Total Operating Expenses [P=M+N+O]	0	0	0	-	-	-
Income from Operations [Q=L-P]	**0**	**0**	**0**	**-**	**-**	**-**
Other Income [R]				-	-	-
Taxes						
Income taxes				-	-	-
Payroll taxes				-	-	-
Real estate taxes				-	-	-
Other taxes (specify)				-	-	-
Other taxes (specify)				-	-	-
Total Taxes [S]	0	0	0	-	-	-
Net Profit [T=Q+R-S]	**0**	**0**	**0**	**-**	**-**	**-**

Profit & Loss [Financial Year xx / xx / xxxx	Mth Actual	Mth Budgeted	$ Difference	YTD Actual	YTD Budget	$ Difference	Annual Budget
Income							
Investments	$886	$2,083	-$1,197	$7,820	$10,419	-$2,599	$25,000
Interest Received	$1,760	$500	$1,260	$8,836	$6,200	$2,636	$21,000
Sales product #1	$9,537	$10,379	-$842	$47,686	$51,897	-$4,211	$124,550
Sales services #2	$975	$2,333	-$1,358	$14,999	$11,669	$3,330	$28,000
New Sales Drive	$0	$833	-$833	$3,263	$4,169	-$906	$10,000
Special provision			$0			$0	$3,500
Additional services		$0	$0		$500	-$500	$1,000
Annual exhibition	$503,551	$472,865	$30,686	$503,551	$472,865	$30,686	$472,865
Annual special Sales drive			$0			$0	$234,270
Sundry Income	$0	$333	-$333	$1,192	$1,336	-$144	$4,000
Total Income	**$516,710**	**$489,326**	**$27,384**	**$587,346**	**$559,055**	**$28,291**	**$924,185**
Expenses							
Accountants Fees	$0	$0	$0	$3,850	$4,000	-$150	$4,000
Audit Fees	$0	$0	$0	$2,464	$2,000	$464	$2,000
Bank Fees	$733	$35	$698	$1,022	$345	$677	$1,000
Computer Repairs	$0	$0	$0	$605	$100	$505	$1,200
Consulting fees #1		$0	$0	$0	$3,000	-$3,000	$4,000
Consulting fees #2	$356		$356	$792	$500	$292	$500
Courier Charges		$0	$0		$50	-$50	$50
Credit Card Costs	$0	$193	-$193	$3,400	$2,624	$776	$5,000
Electricity	$0	$0	$0	$1,613	$1,460	$153	$2,600
Entertainment			$0			$0	$1,000
Filing Fees			$0			$0	$100
Gifts & Promo			$0			$0	$500
International	$0	$0	$0	$468	$6,000	-$5,532	$42,780
Insurance	$823	$779	$44	$4,117	$3,896	$221	$10,000
Legal Fees	$0	$0	$0	$780	$1,500	-$720	$1,500
Marketing/Dev	$0	$5,000	-$5,000	$418	$5,000	-$4,582	$5,000
Function Expenses	$135	$0	$135	$135	$1,500	-$1,365	$6,000
Office Equipment		$100	-$100	$44	$100	-$56	$300
Office Expenses	$355	$100	$255	$673	$270	$403	$1,500
Postage- general	$1,232	$70	$1,162	$2,537	$880	$1,657	$3,500
Printing & Stationery	$0	$100	-$100	$6,520	$2,000	$4,520	$5,000
Rent	$1,751	$1,570	$181	$8,572	$7,848	$724	$18,836
Repairs	$0	$0	$0		$20	-$20	$300
Security – premises	$38	$42	-$4	$191	$208	-$18	$500
Sundries		$200	-$200	$1,336	$0	$1,336	$500
Employment	$13,959	$10,409	$3,550	$66,975	$60,100	$6,875	$145,000
Travel Expenses	$2,295	$82	$2,213	$3,175	$793	$2,382	$12,000
Telephone 1	$617	$485	$132	$3,190	$2,590	$600	$6,500
Telephone 2		$800	-$800		$800	-$800	$2,500
Web Hosting	$1,593	$1,600	-$7	$2,550	$2,000	$550	$2,000
Web Site Devmt		$0	$0	$506	$240	$266	$1,500
Annual exhibition	$425,146	$413,162	$11,984	$425,146	$413,162	$11,984	$454,338
Annual sales drive			$0			$0	$185,100
Total Expenses	**$449,033**	**$434,726**	**$14,307**	**$541,077**	**$522,986**	**$18,091**	**$926,604**

Net Profit / (Deficit)	$67,677	$54,600	$13,077	$46,269	$36,069	$10,200	-$2,419

NOTES:

- If you are a "Limited (Ltd) company", by law you must produce a profit and loss account for each financial year.
- Self-employed, sole traders and most partnerships are not required to create a formal profit and loss account.
- If you are self employed, sole trader and or an exempt partnership you will still need to total all your income and expenses for each financial year, for the purposes of completing and submitting a tax return.

2. Develop a financial plan

2.1 – Set profit targets/goals to reflect owners desired returns

2.2 – Identify working capital requirements necessary to attain profit projections

2.3 – Identify non-current asset requirements and consider alternative asset management strategies

2.4 – Prepare cash flow projections to enable business operation in accordance with business plan and legal requirements

2.5 – Identify capital investment requirements accurately for each operational period

2.6 – Select budget targets to enable ongoing monitoring of financial performance

Profit targets/goals may include:

- Break-even point
- Cost of goods/services sold
- Gross profit/net profit
- Desired actual/notional salary for owners/managers
- Desired return on investment

- Sales turnover/gross fees or income

The first step in developing a financial plan is to make a commitment to the process

Set profit targets/goals	➢ **Break-even point** *See 1.3. Calculate break-even sales point to establish business viability and profit margins* ➢ **Cost of goods/services sold** *See element 1. Identify costs, calculate prices and prepare profit statement* ➢ **Gross profit/net profit** *See 1.2. Calculate prices based on costs and profit margin, as an hourly charge out rate for labour or unit price for products* ➢ **Notional salary** *The notional amount (or notional principal amount or notional value) on a financial instrument is the nominal or face amount that is used to calculate payments made on that instrument. This amount generally does not change hands and is thus referred to as notional.]* ➢ **Desired actual salary for owners/managers** *Setting these expenses are part of the Profit & Loss statement explained in* ***1.5. Prepare projected profit statement to supplement the business plan*** ➢ **Return on investment – ROI** *A performance measure used to evaluate the efficiency of an investment or to compare the efficiency of a number of different investments.* *To calculate ROI, the benefit (return) of an investment is divided by the cost of the investment; the result is expressed as a percentage or a ratio.* ➢ **Sales turnover/gross fees or income** *See 1.4. Identify appropriate pricing strategies in relation to market conditions to meet business profit targets*
Identify working capital	**Current assets LESS current liabilities = working capital** ➢ Working capital measures how much in liquid assets a company has available to build its business. The number can be positive or negative, depending on how much debt the company is carrying. ➢ In general, companies that have a lot of working capital will be more successful since they can expand and improve their operations. Companies with negative working capital may lack the funds necessary for growth.

Identify non-current asset requirements	➢ A non-current asset is an asset which is not easily convertible to cash or not expected to become cash within the next year. ➢ Examples include fixed assets, leasehold improvements, and intangible assets. ➢ It is the **opposite** of current assets.
Prepare cash flow projections	➢ The cash flow forecast (or projections) is the main financial forecast a small business will prepare to measure how much cash is needed to operate the business and when it is needed. ➢ It adds the dimension of time to the annual sales and expenses forecasts so that you can predict the future cash needs of your business on a monthly basis and check whether you will be able to pay your bills. ➢ A cash flow forecast measures liquidity, the ability of the business to meet its commitments as they fall due.
Identify capital investment requirements	➢ The term Capital Investment has two usages in business. Firstly, Capital Investment refers to money used by a business to purchase fixed assets, such as land, machinery, or buildings. ➢ Secondly, Capital Investment refers to money invested in a business with the understanding that the money will be used to purchase fixed assets, rather than used to cover the business' day-to-day operating expenses. ➢ If you are seeking investors for your business, you will most likely find that interested investors prefer to make a Capital Investment, specifying what the money will be used for.
Select budget targets	➢ Budgets and forecasts are a key tool for setting achievable profit targets/goals. A budget is an estimate of the expected financial result for a future period. ➢ The budget is used to measure the performance of the business by comparing the actual results achieved to it and measuring variances and identifying trends. The key to successful and meaningful budgeting targeting is to adopt a conservative and realistic approach.

Executing the financial plan model

- The financial plan should relate to the business plan and should list the key financial objectives which are essential for your business to achieve.
- The document should explain the basic financial needs of the business, starting with the initial capital and your expected cash needs.
- The financial plan should also dovetail with the marketing plan.
- The financial plan needs to include establishment costs which indicate the total funds required to set up your business and cover its operating costs until it becomes profitable.
- The financial plan should include a profit & loss projection including sales forecasts, cost budgets and profit targets for the start up period.

Always consult your Accountant and business adviser to get an independent review of your Financial Plan.

3. Acquire finance

3.1 – Identify start-up and ongoing financial requirements according to financial plan/budget

3.2 – Identify sources of finance, including potential financial backers, to provide required liquidity for the business to complement business goals and objectives

3.3 – Investigate cost of securing finance on optimal terms

3.4 – Identify strategies to obtain finance as required to ensure financial viability of the business

Acquiring finance to get a small business off the ground is a major issue for any potential small business.

On-going finance as well is the lifeblood of the small business.

These questions should be already covered in Activity 2A:

- Calculate your business establishment (start-up) costs and working capital required to operate your business.
- Outline your plan for finance sourcing. What credit products will you use, if any? What documents will you need to support your application for finance? Prepare the documents you require to apply for finance.

Acquiring finance	
Start-up and ongoing financial requirements	➢ It's essential to have an accurate idea of your financial needs. Once you have calculated the amount you'll need to cover your initial start-up costs, you'll also need to factor in your running expenses. ➢ You should also remember that customers may not pay you immediately – but you will still need to pay all your bills to keep trading. ➢ It's sensible to have sufficient capital to cover projected expenses for at least six months. ➢ At the same time, you need to make sure that you have taken into account how much money you need to live on. ➢ In the early stages, a new small business is unlikely to produce spare cash that you can spend on yourself.
Sources of finance, e.g., backers	➢ You may need to finance your starting inventory with bank debt or equity. ➢ Bank Term Loan: A bank term loan is usually used for financing the capital assets of the business. It can sometimes be used to finance part of a business start-up or business acquisition. The loan is repaid over a period of time, and the interest rate may be fixed or floating. ➢ Bank Line of Credit: This is similar to an overdraft for a business. It is important to use the line of credit to finance current assets and the term loan to finance capital assets. One sure way to have a cash flow crunch is to have used all your cash and line of credit to purchase a piece of equipment, only to run out of cash due to a late paying customer. It is not usual to finance a business start-up with a line of credit. It is, however, acceptable to finance short-term cash deficits using your line of credit. ➢ Shareholders Loans: This can only happen in a limited company. You, as a shareholder, lend money to the corporation. This is an alternative method of investing in the company. **Seek professional advice** before deciding if using a shareholder loan is the best strategy for your business start-up. ➢ Investment: This is the equity investment you put into your own company. ➢ Backers: while venture capital may be overflowing for some IT start-ups, the real scenario for small businesses (and worse, home-based businesses) is far different. Capital is hard to come-by, especially if: (a) you do not have a good business idea or business plan that will make

	rich backers run to you in the hope of multiplying their savings exponentially; and (b) you may have a good business idea, but you do not know anyone who matters. The problem is that most beginning "business builders" doesn't know what to believe or which way to turn for help.
Cost of securing finance	➢ There are various sources of finance, each with their own costs. ➢ It is important to carefully evaluate your specific requirements and determine which sources of finance are best suited to your business needs. Typical sources of finance include: ➢ Personal savings ➢ Credit cards ➢ Friends and relatives ➢ Angel Investors ➢ Leases ➢ Bank Loans Each has varying and 'fluid' movement of costs. ➢ <u>Overdrafts</u> and lines of credit – flexible and useful for managing cash flow. Large overdrafts and lines of credit are usually short-term, <u>expensive</u> to service and will be guaranteed by your home or a charge over the business and its assets. Some banks provide established businesses with smaller lines of credit without requiring specific security commercial bills are used for funding immediate inventory or stock needs. They provide a fixed sum advance, usually amounts over $100,000, repayable or rolled over between 7 and 180 days. Generally less expensive to service than an overdraft, commercial bills none-the-less require similar guarantees ➢ <u>Leasing</u>, hire-purchase (HP) and other asset-based finance products are used to fund business assets such as motor vehicles, machinery or equipment. They are available from various financial institutions. Security requirements, terms and interest rates will vary too. ➢ <u>Factoring</u> is when the business 'sells' its income or debtors. The decision to enter a factoring arrangement should be made carefully. Factoring ensures proceeds are available to a business as soon as a legitimate sale is made. Funds from factoring are injected into the working capital of the

	business, improving cash flow.
Strategies to obtain finance as required	<u>Ongoing funding</u> ➢ This is the average amount of an overdraft or line of credit that is used at any one time. E.g. you may wish to have an overdraft limit of $20,000 to provide money for the occasional big expense, but usually you won't use more than $5000 of that credit limit on average. So in this case $5,000 is the level of ongoing funding you need. When applying for an overdraft limit, things to watch out for are: ➢ Higher the overdraft amount higher the fees ➢ Clauses where the lender can demand repayment of the whole loan at any time

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