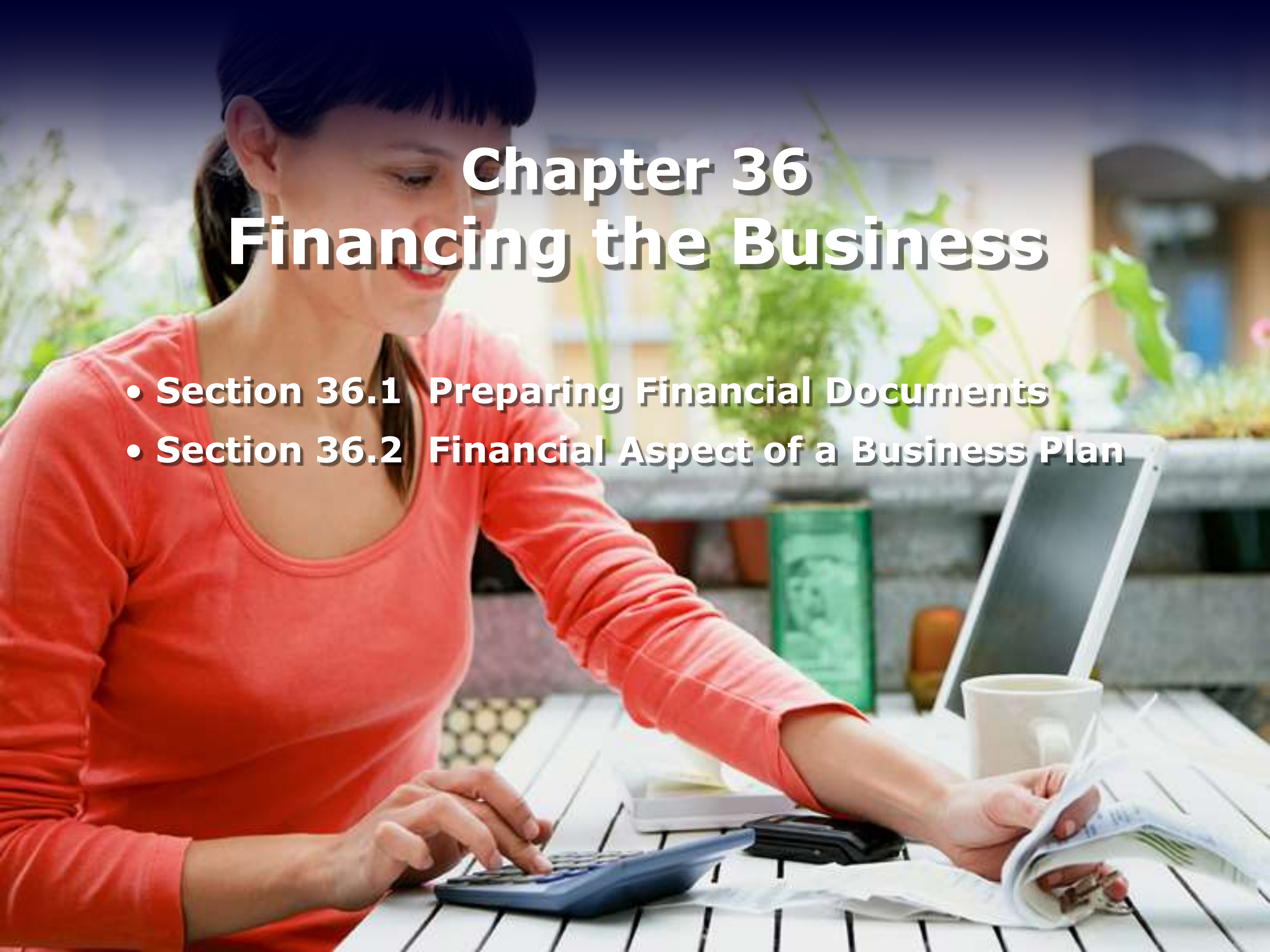


Chapter 36
Financing the Business

- Section 36.1 Preparing Financial Documents
- Section 36.2 Financial Aspect of a Business Plan

Preparing Financial Documents

Key Terms

- personal financial statement
- asset
- liability
- net worth
- start-up costs

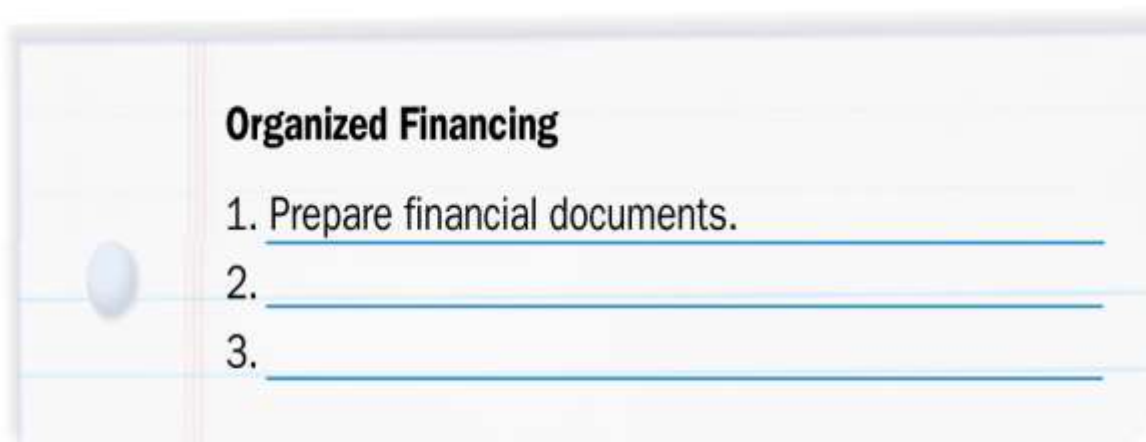
Objectives

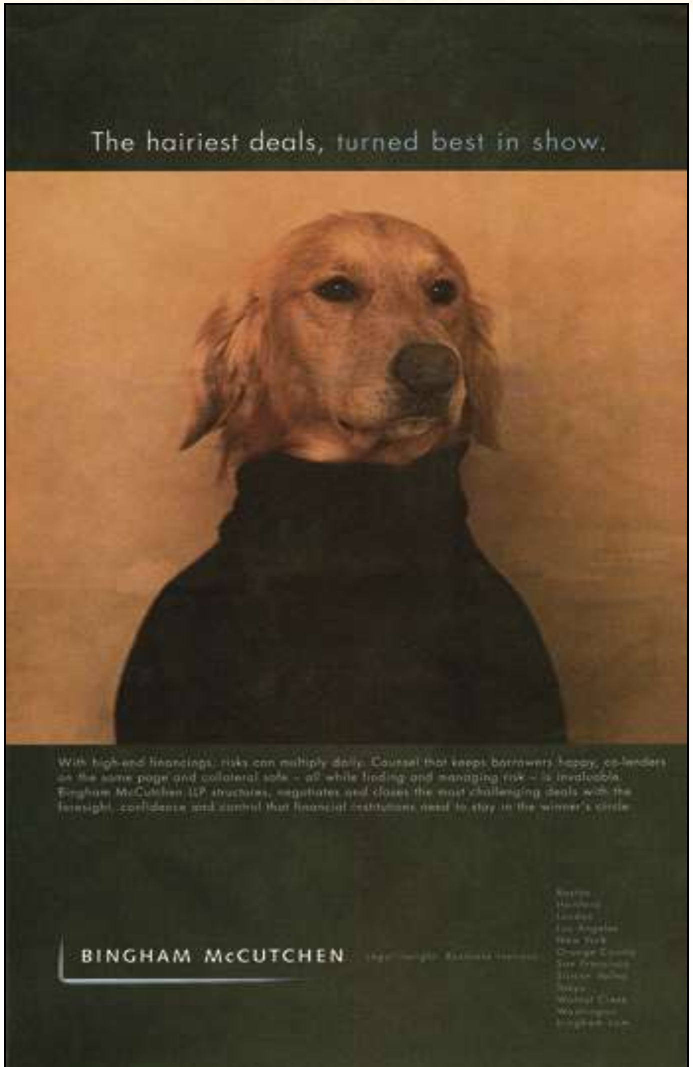
- Explain the purpose of financial documents
- Develop a personal financial statement
- Determine start-up costs for a business

Preparing Financial Documents

Graphic Organizer

In a chart like this one, outline the steps in the preparation of a financial statement.





The Financial Part of a Business Plan

By preparing financial statements, you will be able to determine the amount of money needed to operate the business.

This ad is for a national legal firm that handles high-level financial transactions.

The Financial Part of a Business Plan

A lender will examine your:

- Credit history
- Collateral (items that can be sold to pay off the loan)
- Prospects for business success

The Financial Part of a Business Plan

The five important financial documents in a business plan are the:

- Personal financial statement
- Start-up cost estimate
- Income statement
- Balance sheet and cash flow statement

The Personal Financial Statement

personal financial statement

A summary of a person's current personal financial condition.

The **personal financial statement** is a summary of your current personal financial condition. It compares your assets and liabilities at a particular point in time.

asset

Anything of monetary value that a person owns, such as cash, checking and savings accounts, real estate, or stocks.

liability

A debt that a person owes to others, such as credit card debt, school loans, car payments, or taxes.

The Personal Financial Statement

An **asset** is anything of monetary value that you own, such as cash, bank accounts, real estate, or stocks.

A **liability** is a debt that you owe to others, such as credit card debt, school loans, car payments, or taxes.

The Personal Financial Statement

When listing your assets for a personal financial statement, estimate the present value of each item. Provide a total value for each asset and a grand total for all of them.

Calculate a total for each type of debt and a grand total for all debts.

net worth

The difference between the assets of a business and its liabilities.

The Personal Financial Statement

Net worth is the difference between your assets and your liabilities. To find a business's net worth, subtract its debts from its assets.

Your personal financial statement is one way to determine whether you and your business are good credit risks.

Estimating Start-Up Costs

start-up costs

Projections of how much money a new business owner will need for the business's first year in operation.

Start-up costs are projections of how much money a business will need for its first year of operation. They are based on such factors as:

- The nature of your proposed business
- The size of your business
- The amount and kind of inventory needed

Estimating Start-Up Costs

Business start-up costs may be one-time costs or continuing costs.

- One-time costs are expenses that will not be repeated after you begin the business.
- Continuing costs are operating expenses you will pay throughout the life of the business.

Estimating Start-Up Costs

The Small Business Administration (SBA) provides information to people who want to start a new business. You can also get estimates of start-up costs from people who are already in a similar business or from a trade association.

Personal Costs

You will need money to live on during the start-up phase. Your personal costs are those expenses that are necessary for you to live.

Project your monthly living expenses and household cash needs for at least the first year of business.

SECTION 36.1 REVIEW

SECTION 36.1 REVIEW

PLAY

- click twice to continue -

Financial Aspect of a Business Plan

Key Terms

- income statement
- gross sales
- net sales
- net income
- interest
- principal
- balance sheet
- cash flow statement

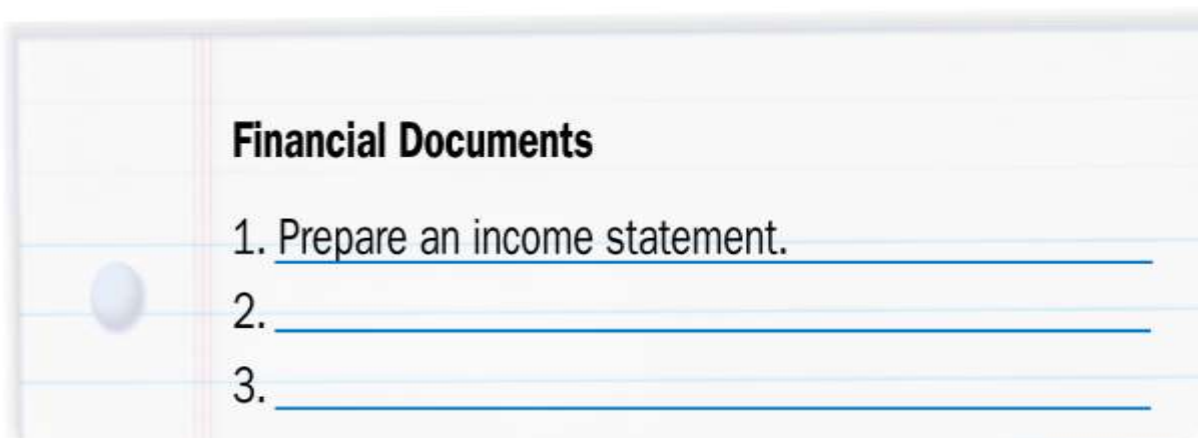
Objectives

- Estimate business income and expenses
- Prepare an income statement
- Create a balance sheet
- Interpret a cash flow statement

Financial Aspect of a Business Plan

Graphic Organizer

In a chart like this one, create an outline that lists key information about financial documents.



Estimating Business Income and Expenses

Estimating your business income and expenses is a key part of your business plan because lenders will want to see your estimates to help them decide whether to lend you money.

income statement

A summary of income and expenses during a specific period of time; also known as profit and loss statement.

The Income Statement

The **income statement** is a summary of income and expenses during a specific period such as a month, a quarter, or a year. It is often called a profit and loss statement.

The Income Statement

Income statements include:

- Total and net sales
- Cost of goods sold
- Gross profit
- Expenses of operating the business
- Net income from operations

Estimating Total Sales

It is important to calculate a reasonable estimated sales volume. You must verify it by comparing it with projected industry figures for your size of business and location.

The accuracy of your sales estimates will also depend on the quality of your market analysis.

Calculating Net Sales

gross sales

The total of all sales for a given period of time.

The total of all sales for any period of time is called **gross sales**. You gross sales will simply be the total of all cash sales if your company sells only on a cash basis.

Calculating Net Sales

net sales

The amount left after gross sales have been adjusted for returns and allowances.

The total of all sales returns, discounts, and allowances is subtracted from gross sales to get **net sales**. The net sales figure is the amount left after gross sales have been adjusted for returns and allowances.

Cost of Goods Sold

The total amount spent to produce or to purchase goods that are sold is called the cost of goods sold. It is found with this process:

	Beginning Inventory
+	**Net Purchases, or Production Costs**
_	**Ending Inventory**
=	**Cost of Goods Sold**

Cost of Goods Sold

Most service businesses do not provide goods to their customers. Therefore, their gross profit is the same as net sales.

Determining Gross Profit

The formula for calculating gross profit is:

$$\begin{array}{ll} & \textbf{Net Sales} \\ - & \underline{\textbf{Cost of Goods Sold}} \\ = & \textbf{Gross Profit} \end{array}$$

Projecting Business Expenses

The next major part of the income statement is the operating expenses.

Variable expenses change from month to month. They include items such as advertising, office supplies, telephone bills, and utilities.

Projecting Business Expenses

Fixed expenses are costs that remain the same for a period of time. They include depreciation, insurance, rent, salaries, and payroll taxes. Depreciation represents the amount by which an asset's value has fallen.

Projecting Business Expenses

To calculate payroll expenses, estimate the number of employees you need, then research typical salaries in your area.

The amount earned by an employee is their gross pay, and their net pay is their salary after taxes, insurance, and deductions.

Projecting Business Expenses

You will need current tax rates for local, state, and federal income taxes. You will also pay FICA and unemployment payroll taxes on your employees' earnings.

To calculate your total expenses, simply add your variable expenses to your fixed expenses.

net income

The amount left after the total expenses are subtracted from gross profit.

Net Income from Operations

Net income is the amount left after the total expenses are subtracted from the gross profit.

	Gross Profit on Sales
–	**Total Expenses**
=	**Net Income from Operations**

Net Income from Operations

interest

The money paid for the use of money borrowed or invested.

principal

Money that is borrowed, sometimes to start a business.

Interest is the money paid for the use of money borrowed or invested.

Principal is the amount you borrowed.

When calculating interest, be sure to check for consistency between the interest rate and the period of time over which you are calculating.

Net Profit or Loss Before Taxes

Net profit or loss before taxes is calculated this way:

	Net Income From Operations
+	**Other Income**
_	**Other Expenses**
=	**Net Profit (or Loss) Before Taxes**

Net Profit or Loss After Taxes

Net profit (or loss) after taxes represents the actual profit from operating a business for a certain period of time.

Net Profit or Loss After Taxes

To prepare a monthly projected income statement:

1. Estimate total sales.
2. Subtract discounts, returns, and allowances from total sales to calculate net sales.
3. List the estimated cost of goods sold.

Net Profit or Loss After Taxes

4. Subtract the cost of goods sold from net sales to find gross profit on sales.
5. List each monthly operating expense.
6. Total the monthly operating expenses.
7. Subtract total operating expenses from gross profit to find net income from operations.

Net Profit or Loss After Taxes

8. Add other income, such as interest on bank deposits, and subtract other expenses, such as interest expense, to find the net profit (or loss) before income taxes.
9. Subtract the total estimated taxes to find the net profit (or loss) after taxes.

balance sheet

A summary of a business's assets, liabilities, and owner's equity.

The Balance Sheet

A **balance sheet** is a summary of a business's:

- Assets
- Liabilities
- Owner's equity

The Balance Sheet

Assets are anything of monetary value that you own. They are classified as either current or fixed.

Current assets are anything of value that can be converted into cash in a year, while fixed assets are used over a period of years to operate your business.

The Balance Sheet

Liabilities are what the business owes. They are classified as either current or long-term.

Current liabilities are debts the business must pay during the upcoming business year, while long-term liabilities are due after 12 months.

Equity is the amount invested in the business.

Analysis of Financial Statements

Lenders look at financial statements and use ratio analysis to determine how a business is performing as compared to others in the industry.

Ratios indicate whether a business has too much debt, is carrying too much inventory, or is not making enough gross profit.

Analysis of Financial Statements

Liquidity ratios are used to analyze the ability of a firm to meet its current debts. One liquidity ratio is current ratio, which is found by dividing current assets by current liabilities.

Analysis of Financial Statements

Activity ratios are used to determine how quickly assets can be turned into cash.

One example is the accounts receivable ratio, which indicates the number of days it takes to collect the money owed by customers. To find this ratio, divide net sales by average trade receivables.

Analysis of Financial Statements

Profitability ratios measure how well the company has operated during the past year. The profit margin on sales ratio shows the rate of profit in percentages. It is found by dividing the net income by the net sales. To find the rate of return on assets, divide net income by average total assets.

Cash Flow Statement

cash flow statement

A monthly plan that tracks when a person anticipates that cash will come into their business and when they expect to pay out cash.

A **cash flow statement** is a monthly plan that tracks when you anticipate that cash will come into the business and when you expect to pay out cash. It helps you determine whether you will have enough money to pay your bills on time.

Cash Payments

The monthly cash flow statement for a business shows:

- Cash paid for merchandise
- Costs for operating the business
- Cash received from cash sales and payments for credit sales

How to Prepare a Cash Flow Statement

To prepare a monthly cash flow statement:

1. Add cash on hand and money from loans to find total start-up money.
2. Subtract start-up costs to find cash left for operation.

How to Prepare a Cash Flow Statement

3. Enter cash expected from sales, business investments, and loans for each month during the first year.
4. Add all sources of cash receipts to find total cash income for the month.

How to Prepare a Cash Flow Statement

5. List the cost of goods you will buy for inventory. Add cash purchases and credit purchases (paid this month) to find the total cost of inventory purchases.
6. List expenses you expect to pay during the month. Do not include depreciation.

How to Prepare a Cash Flow Statement

7. Total all expenses for the month.
8. List amounts that will be paid out for capital expenditures (that is, money to operate the business).
9. List any other payments that will be made.

How to Prepare a Cash Flow Statement

10. Add all cash expenditures (inventory purchases + expenses + capital expenditures + other payments). Subtract total cash paid from total cash received during the month to determine the net cash flow.

How to Prepare a Cash Flow Statement

11. Add the beginning cash balance to the net cash flow. The result is the cash surplus for the month. (If costs are higher than income, the business has a deficit. List the amount of additional cash needed for operations on the Cash Needs line.)

Loans

A loan can help you keep the business going during the start-up period and during slow sales months. If your cash flow statement indicates you need to borrow money to meet monthly expenses, you must include monthly payments on the loan as part of your cash needs for the rest of the year.

SECTION 36.2 REVIEW

SECTION 36.2 REVIEW

PLAY

- click twice to continue -

FOCUS on KEY POINTS

Section 36.1

- Five important financial documents are the personal financial statement, the start-up cost estimate, the income statement, the balance sheet, and the cash flow statement. The personal financial statement is a summary of your current personal financial condition.

continued

FOCUS on KEY POINTS

Section 36.2

- The next step is to estimate the money you expect to earn and to spend operating your business. The financial document that is used to calculate a business's revenue, costs, and expenses is the income statement.

THE DECA CONNECTION

This chapter has helped prepare you to meet the following DECA performance indicators:

- Describe the nature of budgets.
- Explain the nature of overhead/operating costs.
- Develop company's/department's budget.
- Demonstrate orderly and systematic behavior.
- Make oral presentations.

CHAPTER 36 REVIEW

CHAPTER 36 REVIEW

You are X.

Start by picking a square. If you answer correctly, you win that square. If your answer is incorrect, O gets the square.

PLAY

- click twice to continue -