

Finance for Entrepreneurs

Thursday, January 8, 2008

Finance For Entrepreneurs

- Session 1: *The Past*
 - General Concepts
 - Income Statement
 - Cash Flow
 - Balance Sheet
- Session 2: *The Future*
 - Models/Budgets/Forecast
 - Other Concepts/Techniques



Why? Viability, Sustainability...

- Ultimately, whether you call it profit or not, an organization has sustain a net positive generation of resources to support your* goals



**and other constituent's*

But, what's all the fuss...?

There once was an entrepreneur who was having trouble doing her taxes. She called her daughter, a CPA. The daughter came in, asked for the financial records and was pointed to a closet full of paper. The daughter gasped, "Without reports, how do you know how well you're doing?" The entrepreneur answered, "I have my own business, a house, a car, a daughter that I put through college and enough savings to retire soon. Subtract off the fact that I came to this country 25 years ago with nothing, and I'd say I'm doing pretty darn well."



You Have Questions

Starting a Business



Running a Business



Financing a Business



Tools Of The Trade

- Income Statement
- Cash Flow
- Balance Sheet
- Models, Budget, Forecast



Income Statement

It's About Profit

Definition

- A financial statement that measures a company's financial performance over a specific accounting period.
- A summary of how the business incurred its revenues and expenses resulting in a net profit or loss.
- *It's About Profit or Loss – not cash flow*
- *Profit = Change in Net Worth*

Income Statement or P&L

Revenue	\$ 100,000	A
Cost Of Goods Sold	\$ 60,000	B
Gross Margin	\$ 40,000	C=A-B
Operating Expenses	\$ 32,000	D
Operating Income	\$ 8,000	E=C-D
Other Inc/(exp)	\$ (100)	F
Income before tax	\$ 7,900	G=E+-F
Income Taxes	\$ 2,000	H
Net income	\$ 5,900	I=G-H

Important Concepts P&L

- Revenue
- Cost Of Goods Sold
- **Gross Margin or Gross Profit**
- Operating Expenses
- **Operating Income**
- Other Income & Expense
- Income Taxes
- **Net Income/Loss**



Revenue

- Resources generated - money you have collected or have a right to collect – from the provision (or exchange) of goods or services that the company is in the business to provide
- Not including pass-through costs
- Before any costs are subtracted
- Not sales of assets or other non operating activities

Cost Of Goods Sold

- The direct costs of providing the goods or services you sell
- Cost of producing finished goods (including obtaining and storing materials) or services that are sold to customers
- Materials, people, capital assets
- *Ask yourself - what's my inventory?*

Operating Expenses

- Sales
- Marketing
- Research
- Development
- General & Administrative



Fixed & Variable Expenses

- Some expenses vary with revenues
 - Cost Of Goods Sold
 - Sales commissions
 - Advertising
- Some expenses are fixed, no matter what level of revenues may be
 - Rent
 - Salaries



A last word on fixed expenses

- Not enough attention given to it in decision making
- Capital efficient (low fixed) businesses can be more flexible, but less efficient
- Capital intensive businesses (high fixed) can be more efficient, but less flexible
 - *Fixed expenses are often a stepped function*



Expenses With Future Benefits

- Current or Prepaid
 - Insurance
 - Postage
- Long-term/Fixed Assets
 - Depreciating assets
 - *non-cash expense that is subtracted from revenues when calculating net income*

Profit vs. Cash Flow

- Tells me nothing about the cash I collected from customers or paid to vendors (working capital): *I may have more or less cash than I think*
- Depreciation is a non-cash expense: *I may have more cash than I think*
- People invested in me: *I may have more cash than I think*
- I put money into a company car: *I may have less cash than I think*
- Instead of net income, financial analysts are generally concerned with cash flow

Need A Break?



Profit ≠ Cash Flow

	P&L	Non-Cash	Cash Flow
Revenue	\$ 100,000	\$ (20,000)	\$ 80,000
Cost Of Goods Sold	\$ 60,000	\$ (2,000)	\$ 58,000
Gross Margin	\$ 40,000		\$ 22,000
Operating Expenses	\$ 32,000	\$ (7,400)	\$ 24,600
Operating Income	\$ 8,000		\$ (2,600)
Other Inc/(exp)	\$ (100)	\$ 100	\$ -
Income before tax	\$ 7,900		\$ (2,600)
Income Taxes	\$ 2,000	\$ (2,000)	\$ -
Net income	\$ 5,900		\$ (2,600)

Cash Flow

Definition

- A financial statement that shows the firm's cash receipts and cash payments over a period of time from its ongoing operations and other business activities.



Cash Flow Statement

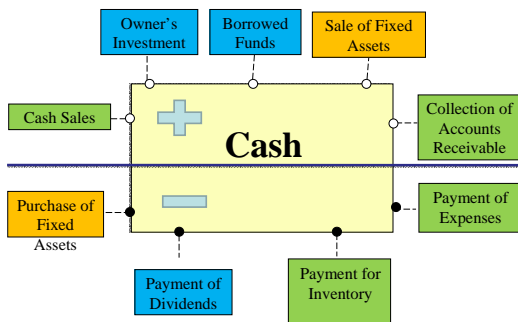
Net Income	\$ 5,900
<i>Changes in</i>	
Accounts Receivable	\$ (20,000)
Inventory	\$ (10,000)
Accounts Payable	\$ 18,400
Deferred Taxes/Interest	\$ 2,100
Depreciation	\$ 1,000
Cash from Operations	\$ (2,600)
<i>Investing Activities</i>	
Purchase of fixed assets	\$ (5,000)
<i>Financing Activities</i>	
Bank loan	\$ 1,000
Equity investment	\$ 10,000
Cash	\$ 3,400

Important Concepts Cash Flow

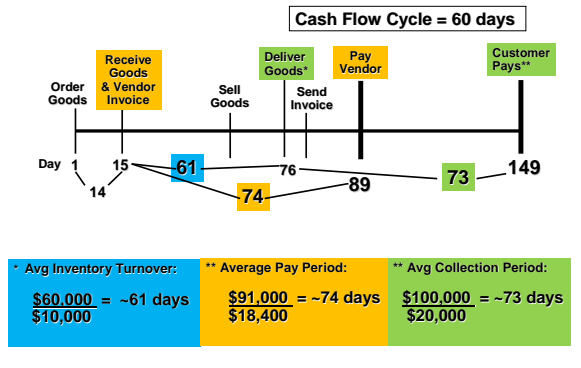
- Operating activities - Cash from operations
 - Depreciation/Amortization
 - Working capital changes
- Investing activities
- Financing activities



Flow of Cash Through a Business



The Cash Flow Cycle



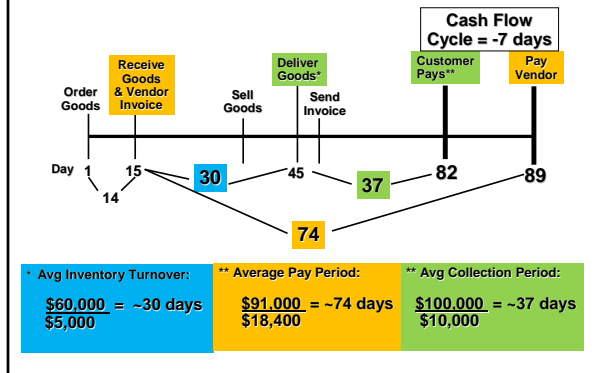
Ways To Improve Cash Flow

- Collect it sooner (early pay discounts?)
- Pay it later
- Turn it faster (make it more predictable?)
- Have fast processes



It's About Speed!!

The Cash Flow Cycle II



Balance Sheet

Definition

- A financial statement that summarizes a company's assets, liabilities and owner's equity (net worth) at a specific point in time.
- A listing of what the company owns and owes as well as the net amount owned by shareholders

Balance Sheet

Assets		Liabilities	
Cash	\$ 3,400	Accounts Payable	\$ 18,400
Accounts Receivable	\$ 20,000	Interest Payable	\$ 100
Inventory	\$ 10,000	Taxes Payable	\$ 2,000
Current Assets	\$ 33,400	Current Liabilities	\$ 20,500
Fixed assets	\$ 5,000	Bank Loan	\$ 1,000
Less Depreciation	\$ (1,000)	Equity	
Long-Term Assets	\$ 4,000	owner's equity	\$ 15,900
Total Assets	\$ 37,400	Liabilities and Equity	\$ 37,400

Important Concepts Bal. Sheet

- Assets
- Liabilities
- Equity (net worth)
- Current Assets and Liabilities-Working Capital
- Hard Assets vs. Intangible Assets



The Balance Sheet

- Assets are the things that a firm owns
- Liabilities are the debts of the firm
- Equity is the difference between assets and liabilities – i.e. Net Worth

Current vs. Long Term

- Listed in order of liquidity
- Liquid within one year = current
- Long term
 - Asset or liability with non-current liquidity or
 - Asset with useful life >1 year

Intangible assets

- Brand name
- Copyrights
- Patents
- Software
- Non-compete agreements, etc.
- *Purchased – generally recorded*
- *Internally developed – not recorded*

Notes on the Balance Sheet

- Accumulated depreciation is an accumulation account
- Common equity is made up of:
 - Common stock and
 - Additional paid-in capital
 - Retained earnings
- Retained earnings is an accumulation account, and changes each period according to the formula:

$$\Delta RE = \text{Net Income} - \text{Dividends}$$

Ratios

- Measures of performance
 - Gross or Profit Margin
 - Turnover (Receivables, Inventory)
 - Sales per XXX
- Measures of Risk
 - Current & Quick Ratios
 - Debt to Equity

