

Small Business Management

Lecture 12

website: <http://sme-centre.massey.ac.nz>



Today' s Lecture

- ▶ Financial planning & control
- ▶ Working capital and tax

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Objective of the lecture

To provide you with some basic information on the various financial statements that are important in the day to day operation and long-term management of a business.

Financial planning & control

Only possible if the business owner

- ▶ has appropriate financial systems
- ▶ uses them effectively

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Financial statements

There are three essential statements:

- ▶ Cashflow
- ▶ Profit and loss
- ▶ Balance sheet

Cashflow

- ▶ Is prepared in advance of the business operation
- ▶ Is used to record the owner's forecasts of cash coming in and going out of the business
- ▶ Is a key element in the business plan and an essential tool for the daily operation of the business

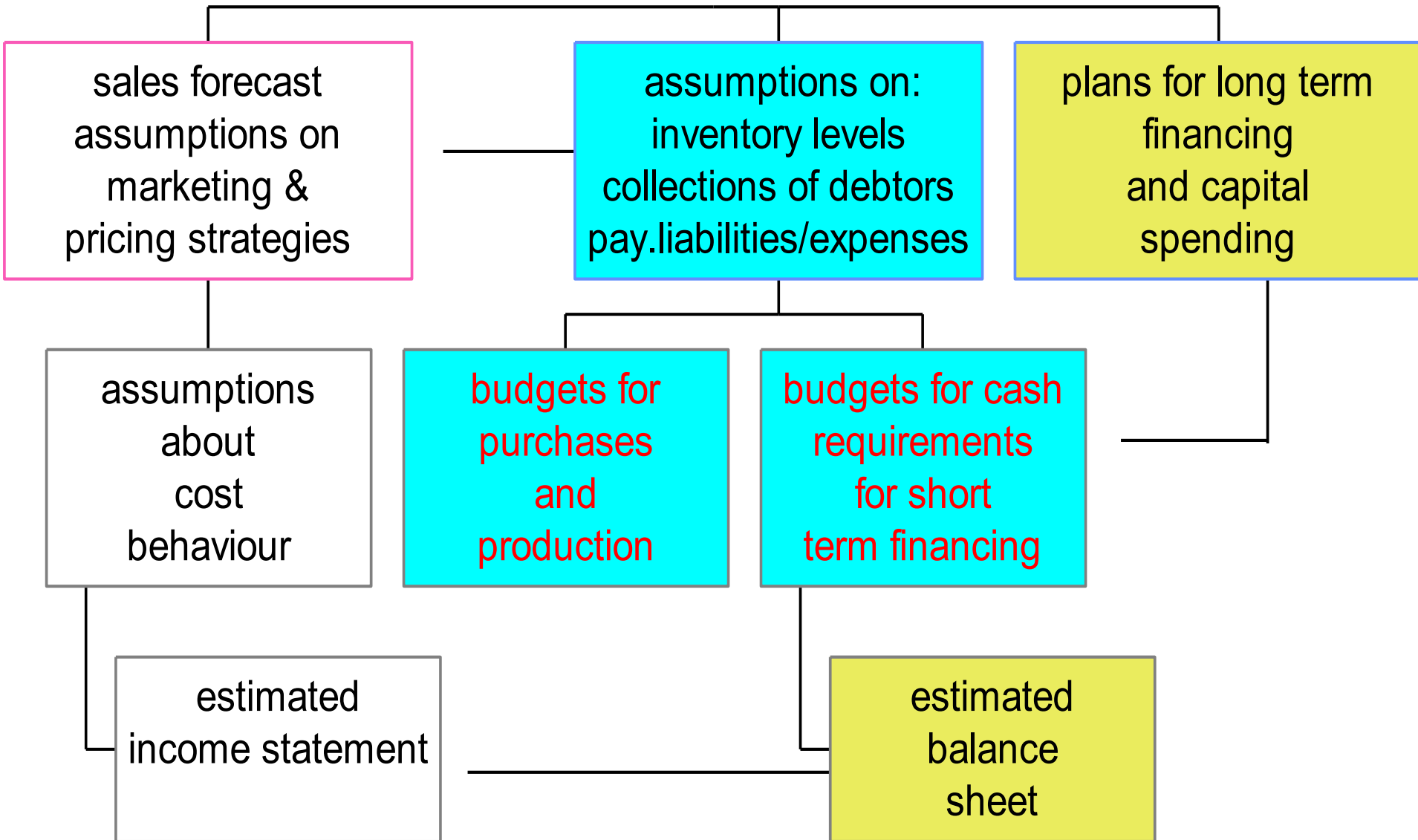
Profit and loss

- ▶ Is also called a statement of financial performance
- ▶ A forecast P& L statement can be prepared in advance of the business operation, but more often used to record performance at the end of a financial period (e.g. the year)
- ▶ Is a key element in the business plan and an essential tool for the long-term management of the business

Balance sheet

- ▶ Is also called a statement of financial position
- ▶ Is used to record the business's position at the end of a financial period (e.g. the year)
- ▶ Is a key element in the business plan and an essential tool for the long-term management of the business

Relationship among financial statements



Cashflow headings

- ▶ Opening bank balance
- ▶ Receipts: cash from sales, cash from debtors, GST, other receipts, sale of assets, capital
- ▶ Payments: payment to suppliers, cash purchases, wages/drawings, PAYE/ACC, GST payments, tax payments, rent, rates, heating/lighting, phone, professional fees, general expenses, capital expenditure, bank interest & charges, other payments
- ▶ Closing bank balance

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Objectives of cashflow forecasting

Allows business owner to:

- ▶ Estimate the business' s ability to generate positive cash flows
- ▶ Assess his or her management of working capital
- ▶ Assess the business' s ability to meet obligations (debt) and pay dividends
- ▶ Construct significant ratios and make comparisons

Preparing a cashflow

A cash flow forecast involves:

- ▶ taking into consideration cash items month by month
- ▶ then calculating the impact they will have on your overall cash position each period

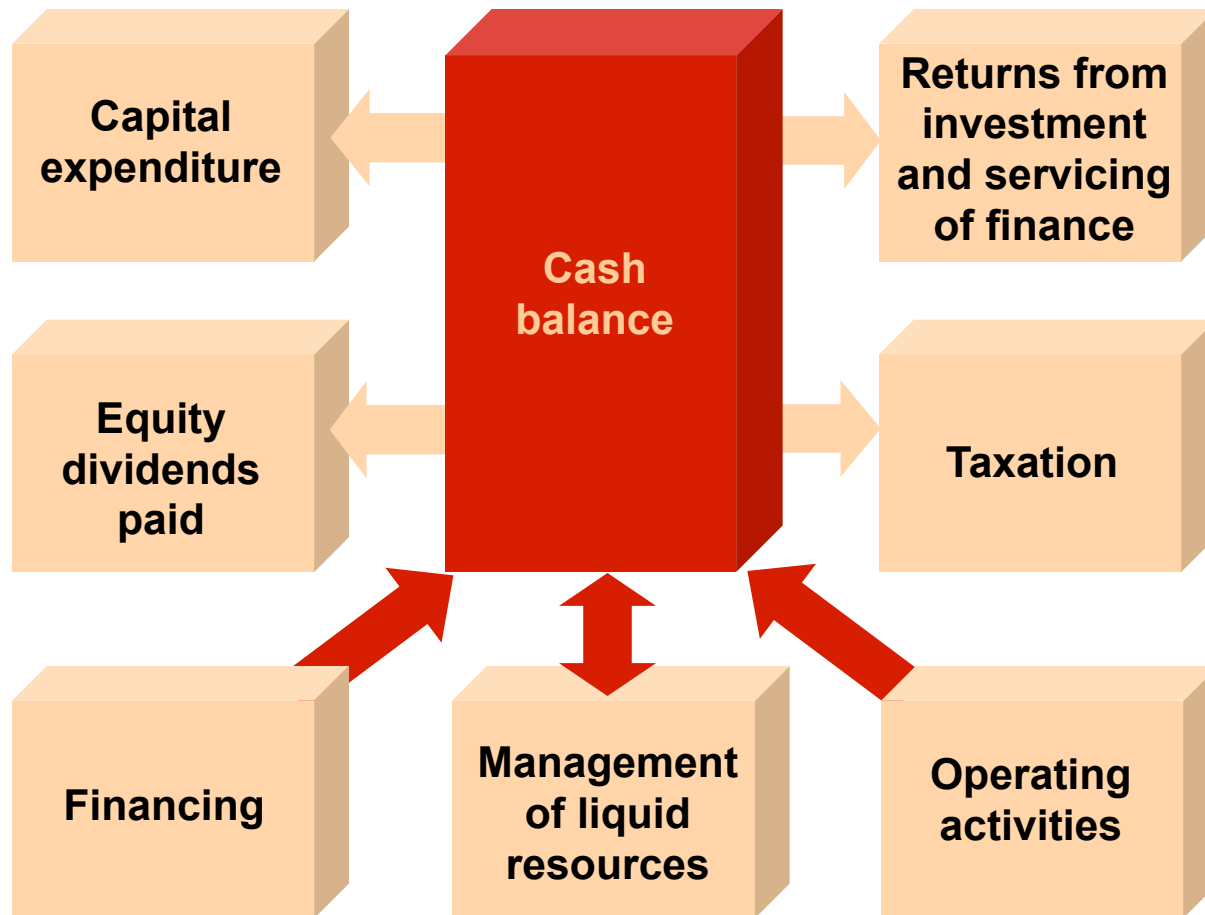
A sales forecast is made by **estimating**

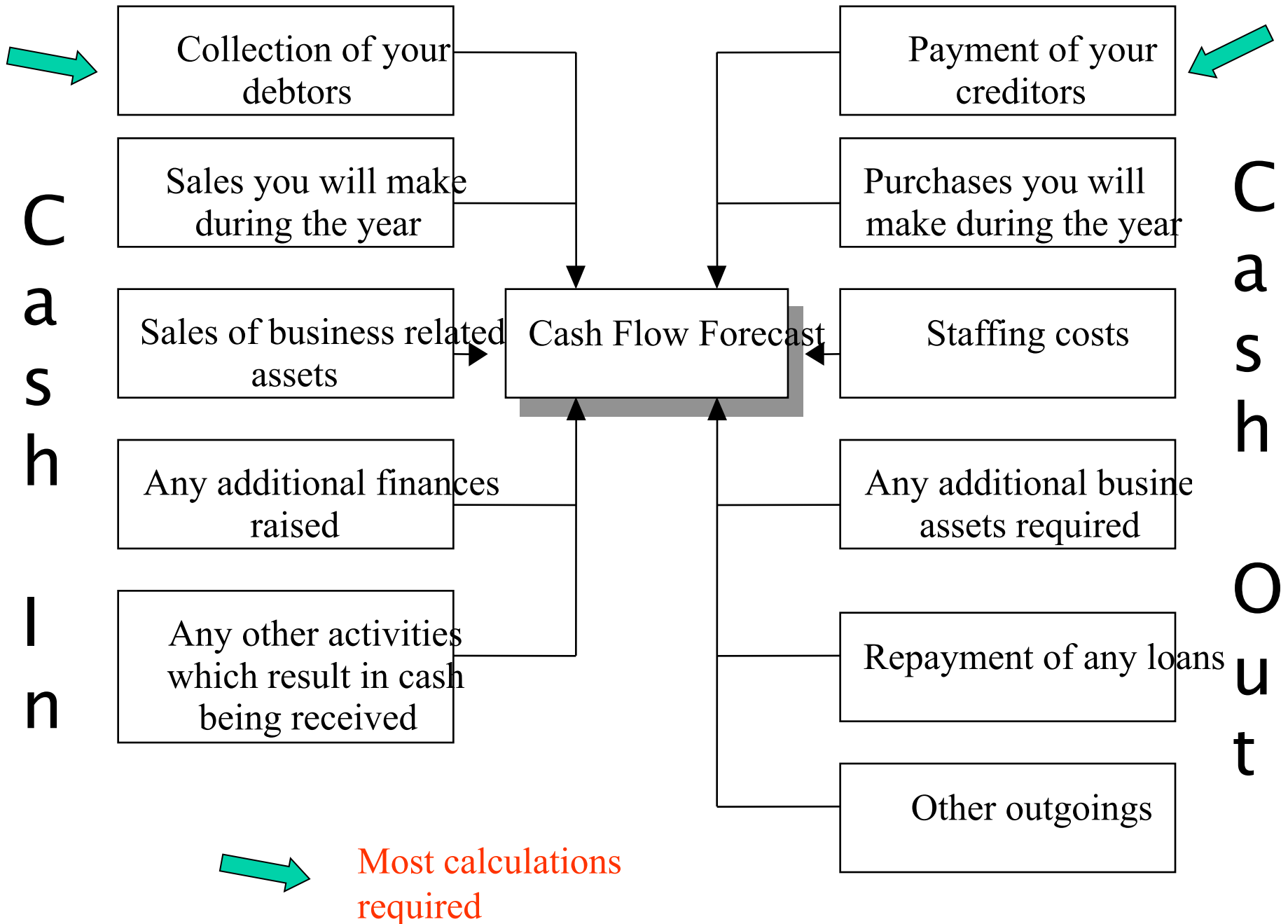
- ▶ Cash Sales
- ▶ Cash Receipts from debtors (credit sales)
- ▶ Expenses

Steps in preparing a cashflow

1. Total cash receipts for the period are estimated
2. Cash expenses are estimated:
(a) stock purchase requirements (b) operating cash expenses
3. Any other cash payments are estimated.
4. Net cashflows for the period are calculated by subtracting the total cash outflow from the total cash inflow.
5. The net cashflow is added or subtracted from the bank balance at the start of the period, to calculate the end-of-period bank balance.

Overview of cashflow items





A typical cashflow forecast

MONTH:	Dec.	Jan.	Feb.	Mar.	Apr.	May
RECEIPTS:						
Cash Sales						
Debtor Collections						
CASH INFLOWS						
PAYMENTS:						
Purchases						
Operating Expenses						
Fixed Asset Purchases						
CASH OUTFLOWS						
NET CASHFLOWS						
Bank Balance, Start of Month						
Net Cashflow for Month						
Bank Balance, End of Month						

Using the cashflow forecast

Helps you:

- Know how much you will need
- Know how much cash you have
- Speed up cash from customers: Most business transactions eventually lead to a business receiving cash

Use the cashflow forecast to:

- Slow down cash outflows
- Make cash work for you (e.g. by earning interest)
- Control receipts and payments (cash can be easily misappropriated)
- Help decide when to use your overdraft
- Speed up cash coming in (consider factoring and invoice discounting)

Summary

- The future is always uncertain, but the figures must be as accurate as possible
- Make any estimates conservative
- Understand the difference between cashflow and profit and loss
- The treatment of GST and depreciation need special attention
- If having problems, seek help from an accountant or enterprise agency
- Use forecasts to judge the future viability of the business.

Working capital and tax

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Objective of the lecture

To provide you with the principles of working capital and some basic information on taxation in relation to the small business.

Working capital

Is the amount needed by the business to
continue in operation on a day to day
basis

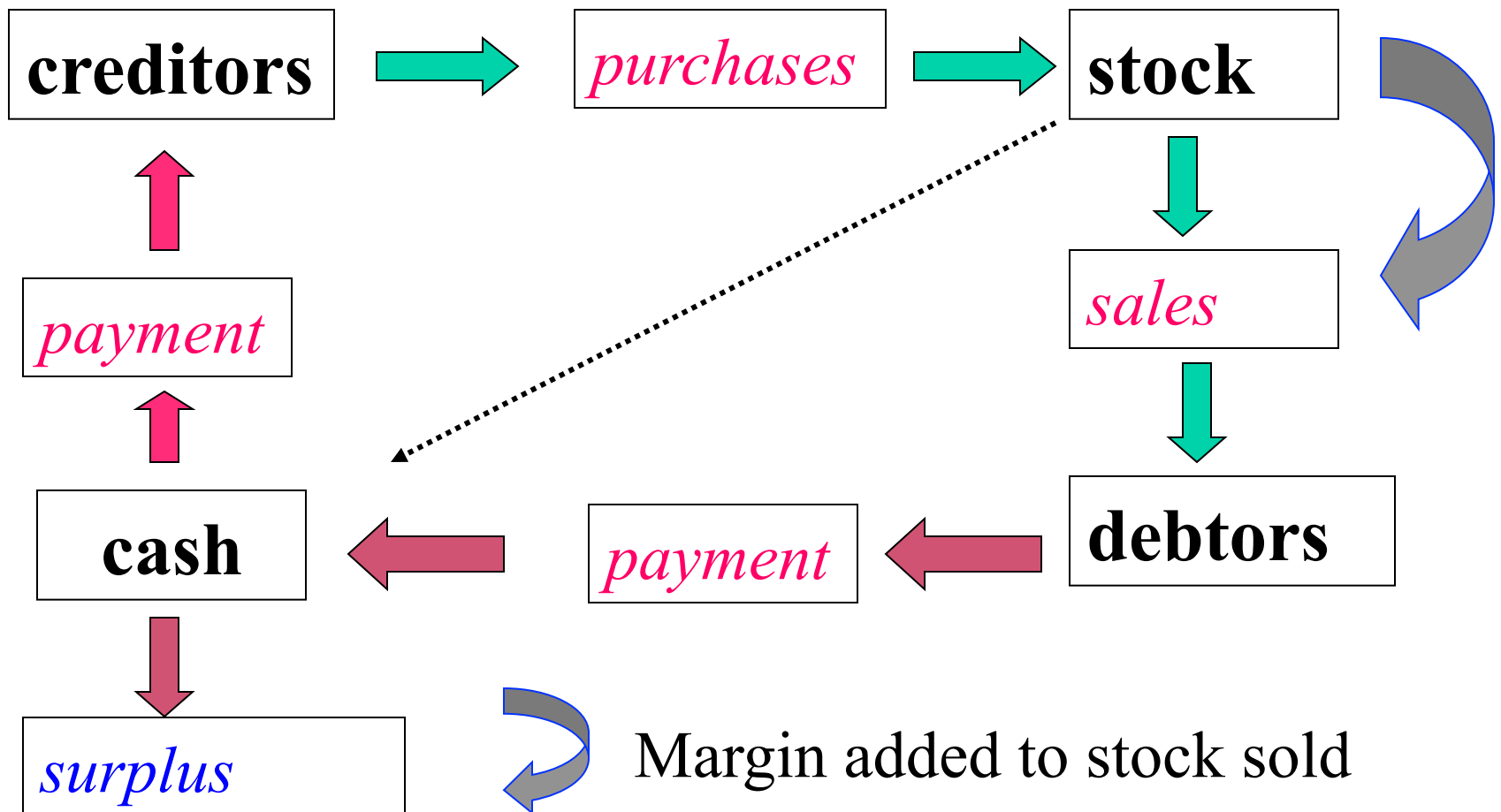
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Working Capital

- ▶ Many firms go bankrupt due to failure to control components of WC, sloppy accounting, data processed late etc
- ▶ WC transactions occur frequently and in quantity, unlike capital expenditure or financing transactions

The trading cycle



Managing working capital

Establish good systems for credit control

- ▶ Avoid poor payers
- ▶ Offer appropriate payment/credit terms
- ▶ Do an 'aged debtor' analysis
- ▶ Chase up money owed
- ▶ do an aged analysis of suppliers

Solvency test

- Must be able to pay bills as they fall due
- Must have liabilities greater than assets after dividends (or drawings)

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Business failure

The warning signs of failure

- Failure to pay suppliers
- Inability to pay bills as they fall due
- Not collecting bills owed to your firm
- Cashflow not forecast & monitored
- Unable to raise more funds
- Losing reputation with your bank or suppliers

Causes of business failure

- Manager takes no advice
- Ineffective division of management roles (e.g. managing director and chairman is same person)
- Board of directors do not take an active interest
- Skills of the business are unbalanced
- No strong financial person
- Business fails to respond to change
- No budget, cash-flow or costing system

How the accounting system helps

An effective accounting system consists of:

- Weekly reports
- Monthly reports: actual results against budgeted results
- Accurate annual financial statements

All records must be kept up to date

Keeping good records

- ▶ Accurate records needed for business survival: is it profitable, what's the return, what's the cash position?
- Needed by law, if a limited company, and for IRD for all businesses
- Records: assets and liabilities, income and expenses & capital
- Large companies have to be audited: small companies, partnerships and sole traders do not have to be audited

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Tax and the owner manager

- It is essential to calculate tax correctly: the penalties wrong payment of tax are severe
- Probably best to seek advice from a professional tax expert
- Tax - provisional tax payments
 - 1st year of business: pay provisional tax
 - 2nd year: pay residue of tax for 1st year, calculate & pay provisional tax for 2nd year of business

Calculating tax

- Tax is payable on the profits a business makes (i.e. income less expenses)

You need to consider

- how you pay yourself (drawings or a salary)
- How to deal with interest and dividends

GST

- A business *must* register if more than \$40,000 sales p.a., optional if less

Summary

- ▶ Develop budgets that are consistent with your business plan
- ▶ Keep good records
- ▶ Compare actual results to budgeted results regularly (e.g. monthly)
- ▶ Take corrective action on variances
- ▶ Control working capital

Reminders

- ▶ Lecture 13 is a revision lecture
- ▶ Marked reports will be available from the departmental office on Tuesday October 21st

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