Financial Statement in Small Business

103 MGT Entrepreneurship

1st semester 1433-1434

Entrepreneur should use three financial statements:

1. Income Statement
2. Cash Flow Statement
3. Balance Statement

Income Statement

- Monthly statement that tracks income and expenses.
- To Find out profit or loss
- Can be called "profit and loss statement"

Cash Flow Statement

- Monthly statement to track the cash going in (inflow) and out (outflow) of the business.
- Helps guide business daily operations
- Sales in Muharam and customer payment in Rajab, income statement shows sale in Muharam, and cash flow statement shows inflow in Rajab.
- Even the business shows profit (income statement), cash may has shortage and the business closes because it can't pay bills.

Balance Sheet

- Prepared once a year.
- It tracks business's performance over year's time (end of the business year).

Income Statement

Includes:

- Sales
- Total cost of Goods Sold (TCGS)
- Gross profit
- Operating cost : Fixed cost & variable Cost[i]
- Profit before taxes
- Taxes
- Net profit or loss

Sales: money that business receives from selling product

TCGS = units x cost of 1 unit

Operating costs: items that must be paid to operate business (F,V) which includes: utilities, salaries, advertising, insurance, interest, and rent.

Net profit or Loss: a business's profit or loss after taxes

Example: Jone' Ties business

Buy 25 ties at $2.00 each
Sale price $4.00
Revenue is $100
Advertisement $24.00

Income Statement

A. sales		100	25 X4 = 100
B. Less TCGS		50	25 x 2 = 50
C. Gross profit		50	A – b = C
D. less operating costs D1. FC D2. VC	 24 + 0	 24	
Profit before tax		26	C – D = E
Taxes		6	
Net profit / loss		20	E –F = G

Financial Analysis

- **Break - even point** (BEP) :

is the point at which your expenses and your revenues are equal.
It shows how many items you need to sell at the given price to cover all your expenses both fixed and variable

- **Payback Period** (PBP):

generating enough revenues to cover all expenses (including business setup costs).

- A business can be break even for years without actually becoming cash flow positive.

Break- even Analysis by Units

(1)

- When Sales = cost in income statement
- To how many units the business must sell to cover cost
- The first step is to define unit of sale (ties, pencil, shoes, an hour of word processing, typed sheet, ….)
- **Break – even point = fixed cost/Gross profit**
- **Gross profit/unit = Unit price – cost per unit**

Jone gross profit per tie = $4 - $2 = $2

- **Break – even unit = Monthly fixed cost/cross profit**

Jone break – even = $24/$2 = 12 ties per month

- Jone must sell 12 ties a month to stay in a business

Break- even Analysis by Units

(2)

Including variable cost

- Monthly fixed cost / Gross profit – v cost per unit = break-even units
- Example:

A shoe store has the following costs:

V cost $1 (sales commission per pair of shoes sold)

Monthly fixed cost $1100

GPPU $12

Break – even units = 1100 / (12-1) = 100 pairs of shoes

Balance Sheet

- Prepared at the end of fiscal year.
- Fiscal year is the twelve months period chosen by business.
- It includes: Asset, Liabilities, owner's equity
- Assets – Liabilities = Capital (owner's equity or net work)
- Every item in a business is finance with debt or equity. That’s why both side of the balance sheet should be balanced.
- Assets: building, land, cash, inventory, furniture….

  Current: that takes one year to transfer into cash

  Long-term: that takes longer than a year to be transferred into cash

- Liabilities: all debts owned by the business like bank loan, mortgages, loans from family and friends…

  Current: that must be paid within one year

  Long-term : that can be paid over a period of longer than year.

- Owner's equity: the value of the business to the owner.

Hometown Restaurant balance sheet, January 19999

Assets		**Liabilities**	
Cash	10,000	Loan (for stove)	5,000
Tables and chairs	3,000	Owner's equity (10,000cash+ 3000tables and chairs+1,100depr.)	11,900
Stove	5,000		
Subtotal	18,000		
Less depreciation	1,100		
Total Assets	16,900	Total Liabilities	16,900

Resources: Mariotti, Steve and others (2000), The young Entrepreneur Guide, Ne York: Three Rivers Press, National Foundation for Teaching Entrepreneurship.

[i] Fixed costs do not depend on the actual production volume. These are the bills you have to pay whether you produce something or just do nothing. Fixed costs are normally listed as Operating Expenses (SG&A) in your Income Statement:

- Salary expenses
- Advertising
- Rent
- Repairs and maintenance
- Car, delivery and travel
- Accounting and legal
- Outside services
- Telephone
- Supplies (office and operating)
- Utilities

Variable costs do depend on your production volume: if your production is zero, these expenses will be around zero, too. And though in the real life you cannot always cancel your variable costs totally, in the long run they are proportional to your production volume anyway. Variable costs are usually provided in Cost of Sales section of your Income Statement. Variable costs examples:

- Cost of materials
- Cost of ingredients
- Wages of workers directly involved in production process