SMALL BUSINESS FINANCES FOR STARTUPS

An Introduction to Business Finance, and Management for Small business

Contents

PREFACE

This book will help small-business owners succeed. Inside, I show you what you need to know to set your business on the path to profits. From maximizing cash to minimizing taxes, Identify start-up and ongoing financial requirements, Balance your budget, manage your cash flow projection, Identify costs, calculate prices and prepare profit statements, and this will help you steer your business toward lasting prosperity.

INTRODUCTION

Money is always dull, even when you have none, and then it is frightening.

A prominent & successful business owner said, there are three crucial things to do for the entrepreneur in the capital-raising process:

- Never run out of money.
- Really understand your business.
- Have a right & excellent product.

Those are excellent pieces of advice but reaching points 1 is more straightforward for many businessmen than achieved.

One of the most common complaints concerning entrepreneurship relates to capital. Entrepreneurs frequently complain that raising money is their most significant obstacle, as it seems like there is never enough and that the fundraising process takes too long. These are not gratuitous complaints. Therefore, few people in business know that capital raising is a cycle that goes on.

However, raising money, whether debt or equity, for start-ups, acquisitions is extremely tough as it should be. The cycle usually takes a few years and several rounds.

Why is capital raising so tough? The most plausible explanation for this is that capital providers are taking immense risks when funding business projects.

Approximately 60 per cent of companies fail in the first four years, and almost nine out of ten fail in 10 years. The success rate is just 10 per cent over a long window. Despite this, capital providers are justified in carrying out extensive due diligence to assess entrepreneurial creditworthiness. To say it may sound sacrilegious to me, but it must be said: those who are businessmen do not have the right to finance merely because they joined the club at the party.

Because capital raising is so tricky, the entrepreneur must be relentless and undeviating in this endeavor.

IDENTIFY START-UP AND ONGOING FINANCIAL REQUIREMENTS

These entail expenses or upfront costs that happen before you launch and start bringing in any revenue. These can be split into *one-time* and *ongoing fees*, and by separating them in this way, you can give yourself a more accurate estimate of what it will take to launch your business. Here are some common expenses to consider in both categories:

One-time expenses

- Permits and licenses
- Brochure and business card printing
- Down payment on rental property
- Logo design
- Incorporation fees
- Signage
- Renovation/Improvements to the chosen location
- Website design

Ongoing expenses

- Rent

- Insurance payments
- Legal services
- Loan payments
- Marketing costs
- Payroll
- Taxes
- Utilities

This makeup just a handful of the potential costs you will need to consider. Many will stay fixed, while others will function as cost variable.

Start-up assets

These are costs associated with long-term assets purchased to start your business. While cash in the bank is the most basic start-up asset (and we will talk more about that later) there are some other common assets you may need to invest in:

- Computers or other tech equipment
- Office equipment
- Office furniture
- Vehicles

SETTING PROFIT TARGET AND GOALS

A clear *profit target* for your business can be a powerful force for change. A bare minimum starting point should be to reach average profitability for your industry, and then you can aim for higher. Your profit goal is the amount of money you need to meet some predetermined commitments that are important to both you and to the future of your business. Identifying a profit objective will help you guide your actions and strategies to achieve your target (once you have established your income drivers).

For more information and great tips visit Business Queensland website: www.business.qld.gov.au

You will need to consider the following to set a **profit target**:

- Costs (both fixed and variable)
- Owner's annual income
- Operating expenses (fixed and variable)
- Return on borrowed capital
- Return for risk
- Return for future growth.

TAX REQUIREMENTS IN AUSTRALIA

Tax is money people and businesses pay to the Australian Government.

If everybody pays their fair share of tax, Australians and their children will always live in the lucky country.

Business tax is the tax that your business pays on its profits. This depends upon which business structure operates the business. The most common business structures are:

- **Sole trader** - Business income is reported on your personal tax return
- **Partnership** - Business income is reported on the partnership tax return. The partners report and pay their share of the partnership income as part of their own tax return
- **Company** - The business income is reported and paid by the company on a company tax return
- **Trust** - The business income is reported on the trust tax return. Depending on the scenario tax may be paid by the trustee of the trust or beneficiaries in their own tax returns

GST is a general tax of 10% on the sale of most goods, services and anything else sold or consumed within Australia.

If a business or organisation is registered for GST, they will include GST in the price they charge for their goods and services unless the sale is GST-free or input-taxed. If a business is not registered for GST, they do not charge GST.

HOW TO CALCULATE GST?

The Goods and Services Tax (GST) in Australia is a standard 10%. This means that to find the GST of an item, which does not already include GST, all you have to do is find 10% of the price. To calculate the amount of GST that is being charged when it is already included in the price, simply divide the total cost by 11. The resulting figure is the GST amount included in the price. So, an item that costs $275 with GST, can be divided by 11. $275 divided by 11 equals $25. This is the amount you have paid as GST.

USE THIS GOVERNMENT WEBSITE TO CALCULATE GST:

https://moneysmart.gov.au/income-tax/gst-calculator

For more information about your Tax obligations visit: www.ato.gov.au

SETTING UP THE BUSINESS COSTS

The very first thing you should calculate before starting a business is setting up costs. These are all the costs you should pay before your business operation. These costs include:

- Accountant fees
- Business registration fee
- Domain (&website) registration fee
- Business insurance
- Licenses (if applicable)
- Equipment and vehicles
- Raw material & supplies

Calculating all your setting up costs gives you the indication of how much money you need. This money can be from your savings, or investors or perhaps from a bank loan.

UNDERSTANDING THE FINANCE CONCEPTS

Here we explain some financial terms you need to fully understand before going ahead.

- **Total sales or Total revenue**
  This is the whole amount you earn by selling your products or service in a period of time. For instance, if you sell 30 units of your products every day, this is your total sale, and if you sell them $10 each, your total revenue will be $300 for that day.

- **Cost of goods sold (COGS)**
  This is all the costs directly involved in making, producing, or manufacturing the product. It is easy to calculate COGS for products, however, it can be tricky to calculate it for services. You should consider the costs of delivering that service. Labour, raw material and maintenance are some parts of calculating COGS, but admin and advertising costs are not part of COGS.

- **Gross profit**

  If you take out Cost of goods from the revenue, you calculated Gross margin. It shows whether each individual product or service is profitable considering the cost of making or manufacturing it. Do not forget this doesn’t include operation and marketing costs, therefore, it is sufficient for our profitability decision-makings. You may have a great Gross profit, which make you believe your business is profitable, but you have to deduct other costs involved as well.

- **Net profit**

  Here we have to add up all the other costs associated with this business and sales; such as marketing and advertising, office and admin costs and depreciation. Net profit is the indication of your business financial health. Ensure you include all the costs before calculating Net profit. Net profit can be before tax or after tax.

CALCULATE PRICES BASED ON COSTS & PROFIT MARGIN

Two margins need to be considered when monitoring your profitability – ***gross margin*** and ***net margin***.

Knowing these figures helps set prices for goods and calculates your sales targets.

- Gross margin

Gross margin is money left after the cost of the items sold from net revenue is subtracted and can be a dollar sum (gross profit) or a percentage value – gross margin is not commonly used for service businesses as they usually don't have the cost of goods.

Net sales are the total value of sales for a given period, less any discounts offered to customers, and commissions paid to sales representatives.

Gross Profit and margin are calculated as:

Gross Profit ($) = Net Sales less Cost of Goods Sold

Gross Margin (%) = (Gross Profit dollars ÷ Net Sales dollars) x 100

You will measure the net profit until you have the gross margin.

Example:

You have a pizza shop and sell each pizza for $15. The material, ingredients and labour cost for each pizza is $8. Then your calculations are as below:

Gross profit ($) : $15 – 8 = $7

($7 for each pizza, multiply for all the pizzas you sell in one day)

Gross margin (%) : ($7 ÷ $15) x 100 = 46.6 %

40-50% is considered a good Gross margin for many businesses.

- Net margin

Net margin is your Profit before you pay any tax (tax is not included because tax rates and tax liabilities vary from business to business).

Net margin is your gross margin less your business overhead expenses, and can be calculated as follows:

Net Profit ($) = Net Sales less total of both Cost of Goods Sold and Overhead Expenses

or

Net Profit ($) = Gross Profit less Overhead Expenses

Net Margin (%) = (Net Profit $ ÷ Net Sales $) x 100

If the net margin is 10%, you can receive 10 cents in income before tax for every dollar of products sold; after all, the cost of sales and operating costs have been charged.

Example:

Your pizza shop spends $450 a month on advertising and $1200 on admin and other overhead costs. By calculating all these costs for each pizza on average (based on number of sales you have), you know that the cost is $4.85.

Now your Net profit for each pizza is: $7 – $4.85 = $2.15

&

Net profit margin is: ($2.15 ÷ $15) x 100 = 14.3%

10-20% Net profit is considered good for many businesses.

CASH FLOW PROJECTION

Cash flow is the amount of money that goes into and out of your company/business. Good cash flow will help put your company on a positive path. Yet bad or negative cash flow will spell doom for your company's future.

If you are trying to forecast the cash flow of your company, build a cash flow estimate. A cash flow forecast estimates the amount of money you expect to flow in and out of your company, including both your revenues and expenses.

Frightened? No problems on that! Look below for an example of a project cash flow statement:

Projected Cash Flow Statement				
	January	February	March	April
Opening Balance	8,000	9,000	11,500	10,500
Cash In				
Sales	10,000	10,000	8,000	8,000
Total	10,000	10,000	8,000	8,000
Cash Out				
Materials	3,000	2,000	3,000	4,500
Marketing	2,000	1,500	2,500	1,500
Wages	4,000	4,000	3,500	4,000
Total	9,000	7,500	9,000	10,000
Cash Flow	1,000	2,500	– 1,000	– 2,000
Closing Balance	9,000	11,500	10,500	8,500

If you want to build your own cash flow forecast, start writing columns for your periods to come. Alternatively, you can use a spreadsheet to coordinate your cash flow claim projections.

In your cashflow forecast you will include the following categories:

Opening balance

Cash in (e.g., sales)

Cash-out (e.g., expenses)

Totals for cash in and cash out

Uses of cash (e.g., materials)

Total cash flow for the period

Closing balance

Periods (e.g., the month of January)

DIFFERENCE BETWEEN CASH FLOW AND PROFIT

Cash is the whole money you have available from sales or receiving payments, but profit is the money left after you take out all your expenses and wages.

Profit is defined as revenue less expenses. It may also be referred to as net income. Cash flow, on the other hand, refers to the inflows and outflows of cash for a particular business. Earning revenue does not always increase cash immediately, and incurring an expense does not always decrease cash immediately.

Cash flow is affected by the amount of money you receive in a month, therefore, the credit payments such as cheques are not included in the cash flow if they are not cashed in that month. Cash conversion rate is the amount of profit that turns to cash in a period of time. High cash conversion rate is sign of healthy business.

TIPS TO IMPROVE CASH FLOW

Cash is king in a business you might heard. You need cash to pay your bills, rent and wages. While assets affect your balance sheet, your business is running by cash. So, healthy stream of cash every month to your business is vital. Many businesses fail just because of poor management of cash flow.

For example, if you pay your suppliers just after you purchased something, but your customers pay you in 2 months, it means that you spent your cash paying your supplier and haven't received anything yet, which make your cash flow negative for that period. Although you are sure your customer will pay you in two months, but you need cash to pay your current bills and wages. This can be more complicated if your customer asks for longer payment terms or doesn't pay on time. The simple rule is trying to pay your suppliers later and receive money from customers earlier. It is harder than we said in real life, but by making a good relationship with your supplier and ensuing them about your future purchases, you might be able to negotiate longer payments terms. For your customers, try to receive a first payment after their order with few progress payments in preferably shorter period of time.

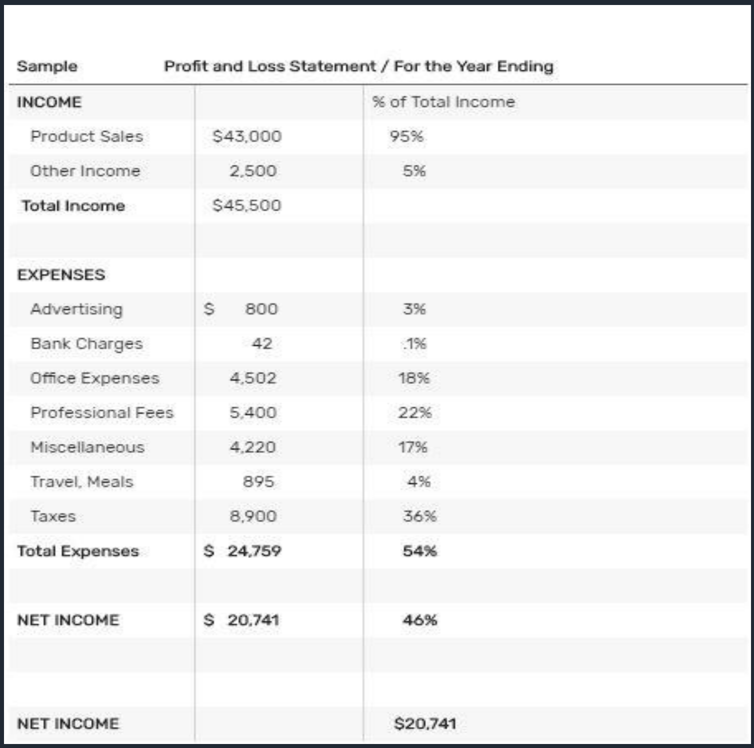
You can also offer discount for early payments to encourage your customers to pay their bill sooner rather later. Don't forget sending invoices immediately after a purchase or service is crucial. Some businesses are delaying this and wonder why customers are not paying them on time. Offering multiple ways of payments are always good and convenient, such as bank transfer, PayPal, EFTPOS etc.

IDENTIFYING COSTS, PRICES, AND PREPARATION OF PROFIT STATEMENT

A return on profit and loss, or income statement, is one of the most critical documents in your company. Even if you do not need money for your small business start-up from a bank or other lender, you will need several financial statements to help you make some decisions. The most critical financial statement that every company need is a report that profit and loss (called "P&L"). Sometimes it is called an income statement.

If you are starting a business, you do not yet have the information to prepare a real Profit & Loss statement, so you should guess or estimate. A pro forma statement is usually prepared in the first month of the business year. Still, your lender may require you to add more months or years to the projection to show the break-even point when your business is generating positive cash flow consistently.

- List all possible expenses, over-estimating, so you are not surprised. Do not forget to add a category for "miscellaneous" and an amount.
- Estimate monthly sales – under-estimate sales, both in terms of timing and number.
- The difference between expenses and sales is usually negative for a while. The negative amounts should be accumulated to give you an idea of how much you will need to borrow to get your business started.



Sample	Profit and Loss Statement / For the Year Ending	
INCOME		% of Total Income
Product Sales	$43,000	95%
Other Income	2,500	5%
Total Income	$45,500	
EXPENSES		
Advertising	$ 800	3%
Bank Charges	42	.1%
Office Expenses	4,502	18%
Professional Fees	5,400	22%
Miscellaneous	4,220	17%
Travel, Meals	895	4%
Taxes	8,900	36%
Total Expenses	**$ 24,759**	**54%**
NET INCOME	**$ 20,741**	**46%**
NET INCOME		**$20,741**

HOW TO FUND YOUR START-UP?

As discussed, you need cash to start your business. After calculating your start-up and running costs, you have different options to fund your new business. Here are some of the most certain ways to fund your start-up:

1- *Your potential customer(s) can invest in your business in advance*
If you have a promising prospect and you are their unique solution, you have a good chance to be invested by your customer. Find a major customer, or a complimentary business, who sees such value in your idea that they are willing to give you an advance on royalty payments to complete your development.

2- *Angel investors can be your saviour*
Angel investors are individuals who invest in start-up businesses; normally in the early stages.

3- *Get a bank loan*
In general, this won't happen for a new startup unless you have a good credit history or existing assets that you are willing to put at risk for collateral.

4- *Get the money you need from Crowdfunding*
Crowdfunding is a way for people, businesses and charities to raise money. It works through individuals or organisations who invest in (or donate to) crowdfunding projects in return for a potential profit or reward.

Best Crowdfunding Sites to Fund Your Startup

- Kickstarter. Kickstarter is one of the most popular and best overall **crowdfunding** sites. ...
- Indiegogo. Similar to Kickstarter, Indiegogo allows users to create funding campaigns and share their stories. ...
- GoFundMe. GoFundMe is best for personal funding, but often works well for business projects too. ...
- Patreon
- Fundable.

5- *Ask your family and friends to invest in your business*

Who understand you better than your family and friends? Try to pitch your idea in a convincing way and ask them to trust you and invest in your new business.

Your journey to your startup finance management is not finished here. There are more to learn and you have to keep upgrading your skills to be able to cope with unprecedented events in your business. Knowing concepts in this book is definitely a good start to make your comfortable savvy business owner.

Good luck running your business. 😊