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Introduction to finance and setting up a small business

Week 1 - Wednesday 23rd March

What is finance

Describes two related activities:

- The study of how money is managed
- Process of acquiring needed funds

Separated into three sub-categories:

- Personal finance → Retirements expenses, which means investing enough money during their working years
- Corporate finance → Decide whether to raise additional funds through a bond issue or stock offering
- Public finance → Governement body has responsibility, goals include attaining an equitable distribution of income for its citizens and enacting policies that lead to a stable economy

These categories are concerned with activities such as pursuing sound investments, obtaining low-cost credit, allocting funds for liabilities, and banking.

Types of businesses

Sole trader

- Trade your own and control and manage the business
- Debts and losses can not be shared
- ADV: Inexpensive to set up, few legal tax formalities when setting business, full control, receive full benefit profits made, keep all after-tax gains when business sold

Partnership

- Association of people who carry on a business as partners or receive income jointly
- Control and management of the business is shared
- Income and losses shared among partners
- ADV: Inexpensive to set up, greater access to finances from the resources of all partners, more people to share work load, more people to share losses and legal responsibilities

Company

- Distinct legal entity, regulated by *Australian Securities & Investments Commission* (ASIC)
- Complex business structure, higher set-up costs and administrative costs
- ADV: Far greater access to capital for the running of the business, pays tax on its own profile, shareholders not liable for the debts, increased asset protection

Things to consider when starting a business: registered ABN, GST & business name, adequate protection for intellectual property, understand tax and legal requirements, set up record keeping, insurance?

Business ethics

- Business ethics, *corporate social responsibility (CSR)* and corporate citizenship reflect the fact that organisations have fundamental responsibilities to stakeholders other than their shareholders → comply with local, state and federal regulations
- Measured by **triple bottom line:**
  - People (human capital) – how the organisation practices towards employees
  - Planet (natural capital) – How sustainable the organisations environmental practices are, benefits to the environment, if company is reducing carbon footprint
  - Profit (the bottom line) – How much organisation contributes to economy

CSR (Corporate Social Responsibility)

Def: Continuing commitment by businesses to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large

Important because:

1. Many customers prefer to purchase from socially responsible organisations
2. Many employees prefer to join socially responsible organisations
3. Many investors prefer to invest with socially responsible organisations

Balance sheet: Assets, equities, liabilities (MORE ON PG 4)

Current assets: Assets converted into cash, sold or consumed within a year or less			
Cash and cash equivalents	What the company has in cash in the bank	**Accounts receivable**	Money that is owed to the company for the goods and services it has provided to customers on credit
Inventory	Raw materials and items that are available for sale	**Prepaid expenses**	Payments that have been made for services that the company expects to receive in the near future
Non-current assets: Not expected to be realized within twelve months			
Long-term investments	Investments that management does not expect to sell within the year, e.g. bonds, common stock, long-term notes	**Intangible assets**	Non-physical, but valuable. E.g. Intellectual property, goodwill.
Fixed assets	Durable physical properties used in operation, longer than a year (machinery, equipment, buildings, land, etc.)		
Current liabilities: Assets converted into cash, sold or consumed within a year or less			
Accounts payable	Owed to suppliers for products and services that are delivered but not paid for	**Wages, rent, tax, utilities**	Amount paid to employees, landlords, government and others
Customer prepayments (unearned revenues)	Payments received by customers for products and services that the company has not delivered	**Dividends payable**	Occurs as a company declares a dividend but has not of yet paid it out to its owners
Long-term liabilities: Obligations that are reasonably expected to be liquidated at some date beyond operating cycle.			
Loans (long-term debt)	Long-term debt net of current portion	**Long-term capital lease obligation**	Written agreement under which a property owner allows
Equity			
Retained earnings	Total net income (or loss) less the amount distributed to the shareholders in the form of a dividend since company open	**Common stock**	Investment by stockholders and it is valued at par
Preferred stock	Investment by preferred stockholders, which have priority over common shareholders		

Feasibility study

- Clearly identify your business ides → Describe what it is, how it will work, who will buy your product or service, and what is does
- Identify business objectives → Why do you want to start a business? Short-term and long-term goals
- Work out business location → Actual address and floor plan
- Identify potential customers → Find out what purchase patterns are. How often they will buy and in what quantities? Their average spend. Identify suppliers. What can they provide, costs?
- Staffing requirements → What duties you need? Their wages? How to hire and cost?
- Assess the business establishment costs
    - Working capital
    - Accommodation and equipment costs – rent, utilities, communication, computers, technical machinery, point of sale, equipment, etc.
    - Legal registration and consultants' fees
    - Promotion and display materials

Bookkeeping
Def: Involves the process of recording, analysing and interpreting the financial transactions of a business. Accounts for a large proportion of the accounting process

- Set up **financial statements** so that an accountant can easily perform legal and tax management in a timely manner
- Records must be kept that are accurate and true for a period of at least 5 years from the date that the documents were prepared, obtained or the transaction completed, whichever occurs the latest
- Payroll must be kept for a minimum of 7 years

Basic accounting concepts

- Business transaction → Begins with a business transaction. This leads to a financial transaction which may be cash paid or received, or monies owing
- Source documents → Each business transaction produces source documents such as receipts and invoices
- Journal entry → Four main types of journals where day-to-day transactions are recorded – cash receipts journal, sales journal, cash payments journal, purchases journal
- General ledger → List of all balance sheet income and expense accounts
- Trial balance → List of all the accounts (assets, liabilities) and their balances. This list separates the accounts according to whether their balances are in debit or credit.
- Financial statements → Consist of mainly the **balance sheet** and **profit and loss statement**

Double entry bookkeeping
Double entry system of accounting is based on the view that there are two entries for every business transaction. Bookkeeping entries are divided into debits and credits.

- **Debits:** Record transactions relating to purchases, expenses and an increase in assets of the company
- **Credits:** Record transactions relating to revenues and an increase in liabilities of the company

Double entry system allows you to check that your books are always in balance – because debits always equal credits. This system prevents common bookkeeping errors and should ensure that any errors are made easier to find.

Budgeting principles

Week 2 & 3 – Wednesday 30th March & Wednesday 6th April

Working out start-up costs
Estimate start-up costs

- One-off costs (establishment costs, e.g. license fees, insurance)
- Cost of purchasing all necessary equipment to be used in the business over the next few years (e.g. assets such as equipment, tools)
- Working capital, which is the money you need to set aside to cover the initial set-up dtage of your business for running costs

Premises

- Site design/architectural plan
- Basic premise modifications: electrical, lighting, painting. Security system, ventilation system
- Fit-out kitchen installation, bathroom construction and plumbing (gas and water)

Compliance needs

- License Business registration, ABN, GST, council permits
- Food handling cert, RSA
- Insurance, public liability, professional indemnity, building, contents, income, WorkSafe, etc.
- Legal work and lawyer
- Accounting work and bookkeeper/accountant

Marketing

- Graphic design for signage
- Website design, internet connection/hosting fees, domain name registration
- Opening marketing, including advertising

Staff

- Recruitment costs
- Wages, salaries
- Uniforms

Fees

- Banking or loan fees/costs
- Electricity, telephone, fax, internet connection and running fees

Running costs
Running costs include wages, buying of stock, Internet access, shipping delivery fees, rent, utilities. (Fill out detailed profit and loss sheet in financial statements template)

Cash flow forecast for your business
Cash flow forecast is the most important business tool for every business. Tells you if your business will have enough cash to run the business or pay to expand it. Also shows when more cash is going out of the business, than in.
Prepare the income or sales for the business – a sales forecast

- Estimate all the cash outflows → You'll get an idea of how much cash needs to come in to cover the cash going out