ESCOLA POLITÈCNICA SUPERIOR
UNIVERSITAT DE LLEIDA

CHAPTER 5:

ECONOMIC-FINANCIAL STRUCTURE OF THE BUSINESS

Master's Degree in Informatics Engineering

POLYTECHNIC SCHOOL

University of Lleida

Universitat de Lleida
Escola Politècnica Superior

5.1 Financial information and balance sheet

BALANCE SHEET

ASSETS ⟷ **EQUITY AND LIABILITY**

ASSETS	EQUITY AND LIABILITY
Non-Current Assets	Equity
Current Assets	Non-current liabilities
	Current liabilities
(Economic structure)	(Finance Structure)
Investments	Financial Resources

ASSETS
(Application of Resources, Investments)

This is the group of goods, services and rights of a company.

NON-CURRENT ASSETS

Non-current Assets are constituted by the various assets or rights that serve to house the productive unit and that allow the development of productive processes. They are considered long-term investments for which the full value will not be realized within the accounting year.

They are composed by:

Tangible Assets: are constituted by the physical goods property of the company or the project.

- Can be amortized: Vehicles, Machinery and instrument , Furniture and utensils , Installations,….

Concepts	% Max.	Min. Years
Hardware	25	8
Software	33	6

- Cannot be amortized: Land.

Intangible Assets

- Non-physical goods (can not touch, weigh and measure)
- Rights of the company, necessary for its operation. Patents, trademarks, goodwill, industrial or commercial designs, investments and all previous costs that include pre-feasibility study, costs of organization, installation and assembly, interest accrued during the implementation, costs of personnel training, studies of engineering, etc.
- Some of them can be amortized, usually during the first five years.

CURRENT ASSETS

- **Current Assets** are constituted by the investments necessary to cover the costs generated by the operation or the normal operation of the company within the current fiscal year or operating cycle.
- They are composed by the needs of:
  - Cash or equivalents
  - Inventories
  - Commercial debts and other accounts receivable
  - Current investments as capital instruments, …

ECONOMIC ASPECTS OF THE PROJECT

- **TOTAL INVESTMENT (ASSETS)**
  - **NON-CURRENT ASSETS**
    - **Tangible**
      - **Depreciate**
        - Vehicles
        - Machinery and instrument
        - Furniture and utensils
        - Installations
        - Buildings
      - **Not Depreciate**
        - Land
    - **Intangible**
      - **Depreciate**
        - Development
        - Concessions
        - Patents, licenses, trademarks and similar rights
        - Goodwill
        - Computer software
  - **CURRENT ASSETS**
    - Cash or Cash equivalents
    - Trade and other receivables
    - Inventories
    - Current investments

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EQUITY AND LIABILITY
(Source of Resources)

It is the group of capital, debts and obligations of a company

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LIABILITIES
(External Resources)

- They are any debts your company has, whether it's bank loans, mortgages, unpaid bills, or any other sum of money that you owe someone else.
- When you look at your accounting software or spreadsheets and look at your liabilities, you're asking: **"How much do I owe?"**
- If you've promised to pay someone in the future, and haven't paid them yet, that's a liability.

LIABILITIES
(External Resources)

- Some popular examples include:
  - Accounts payable: payments you owe your suppliers.
  - Bank loans: the principal you owe investors.
  - Salaries and wages payable: what you've agreed to pay your employees in the future but haven't paid out yet.

LIABILITIES
(External Resources)

- **Non-current liabilities:** Non-current liabilities are a business's long-term financial obligations that are not due within the current accounting year.
  - Examples of noncurrent liabilities include long-term borrowing, payable bonds and long-term lease obligations.

- **Current liabilities:** are a company's debts or obligations that are due within one year, appearing on the company's balance sheet and include short term debt, payable accounts, accrued liabilities and other debts.

EQUITY
(Internal Resources)

- It is the right of the owners on the assets.
- It is the property of the shareholders in the business.
- **"How much is left over?"**

- The Equity equation:

  Equity = Assets – Liabilities (or Assets = Equity + Liabilities)

- Inside the **Equity** we can find the concept *Profit* (positive or negative):

  Profit = Income - Expenses

5.2 Incomes and expense forecasts

INCOMES STATEMENT OR PROFIT

If:

- **Incomes > Expenses** ➡ **GAIN (EQUITY)**
- **Incomes < Expenses** ➡ **LOSS (ASSETS)**

Incomes

- They come from of all the sales of products and/or services that handles the business.
- Therefore, it is very important to know and carry a control of all the products and/or services that offer.

Expenses

- Money spent or cost incurred in a company's efforts to generate revenue, representing the cost of doing business.

Incomes – Expenses = Profit

If:

- **Profit > 0** ➡ **Gain (goes in Equity)**
- **Profit < 0** ➡ **Loss (goes in Assets)**

COSTS OF THE PROJECT

Two classification:

- **Direct and indirect costs**: directly or not associated to the product/service.
- **Variable, fixed cost**: they change or not when the production changes.

Direct costs

- **Direct costs:** those that can be completely identified with the product, activity or department. Are those costs that are related to the product and that are easily traceable economically.
- Examples:
  - Software (licenses or subscription).
  - Products needed.
  - Raw material.
  - Work hours.

Indirect costs

- **Indirect costs:** can not be identified with a product, activity or department, but are necessary for the preparation of a finished item or a service rendered.
- Examples:
  - Energy is important in an ICT project but can not be directly identified with a project activity.
  - Overheads / Extra purchases.
  - Office material.
  - Outsourcing

Variable costs

- **Variable costs:** are those that change or fluctuate in direct relation to a given activity or volume.
- These costs increase when production or sales increase and decrease when the volume of production decreases.
- Examples:
  - Commissions.
  - Shipping costs.
  - Productivity.

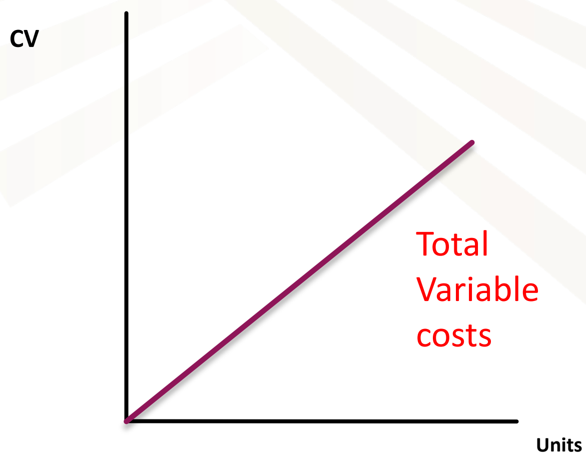
Fixed costs

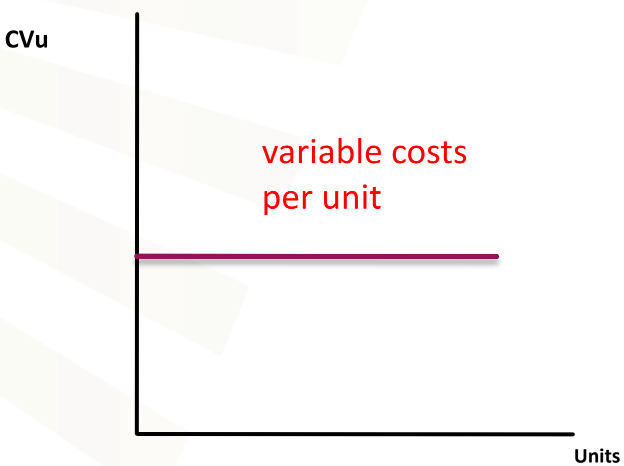
- **Fixed costs:** those that remain constant within a certain period of time regardless of whether the volume changes, or for a certain level of activity. They are independent of the level of production or sales.

- Examples:
  - Rents.
  - Administrative wages.
  - Cleaning service.

Total Variable costs per unit

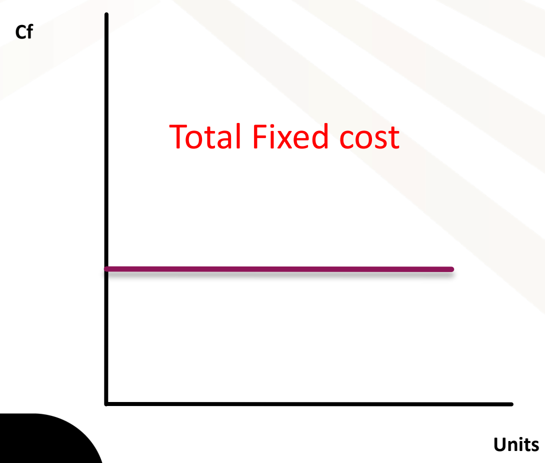
- The variable costs are fixed in unit terms, that is, the unit cost will always be the same and the total variable cost will vary in total terms.

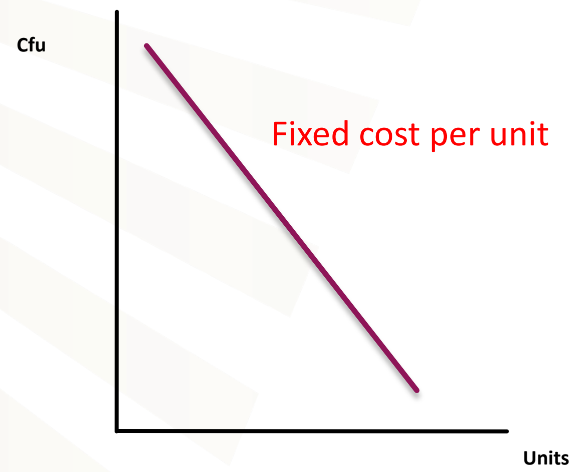




Total Fixed Costs vs per unit

- On the other hand, the fixed costs at the unit level are variable since they are only valid for a certain level of production and the total level of fixed costs does not change.





Break-even point (BEP)

- **Break-even point:** the level of production at which gains equal losses (Incomes=Expenses).

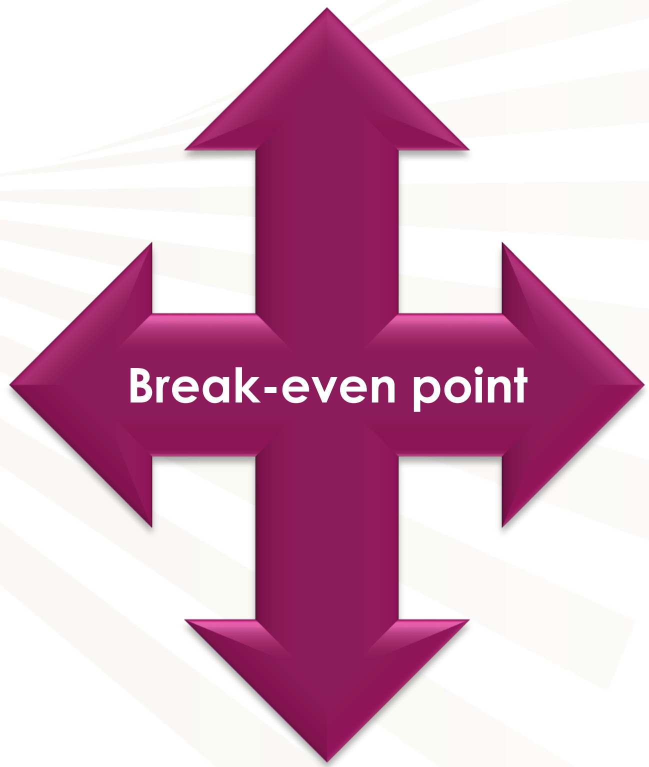
Key point for any project or business

Break-even point

There are gains

Total income > Total Costs

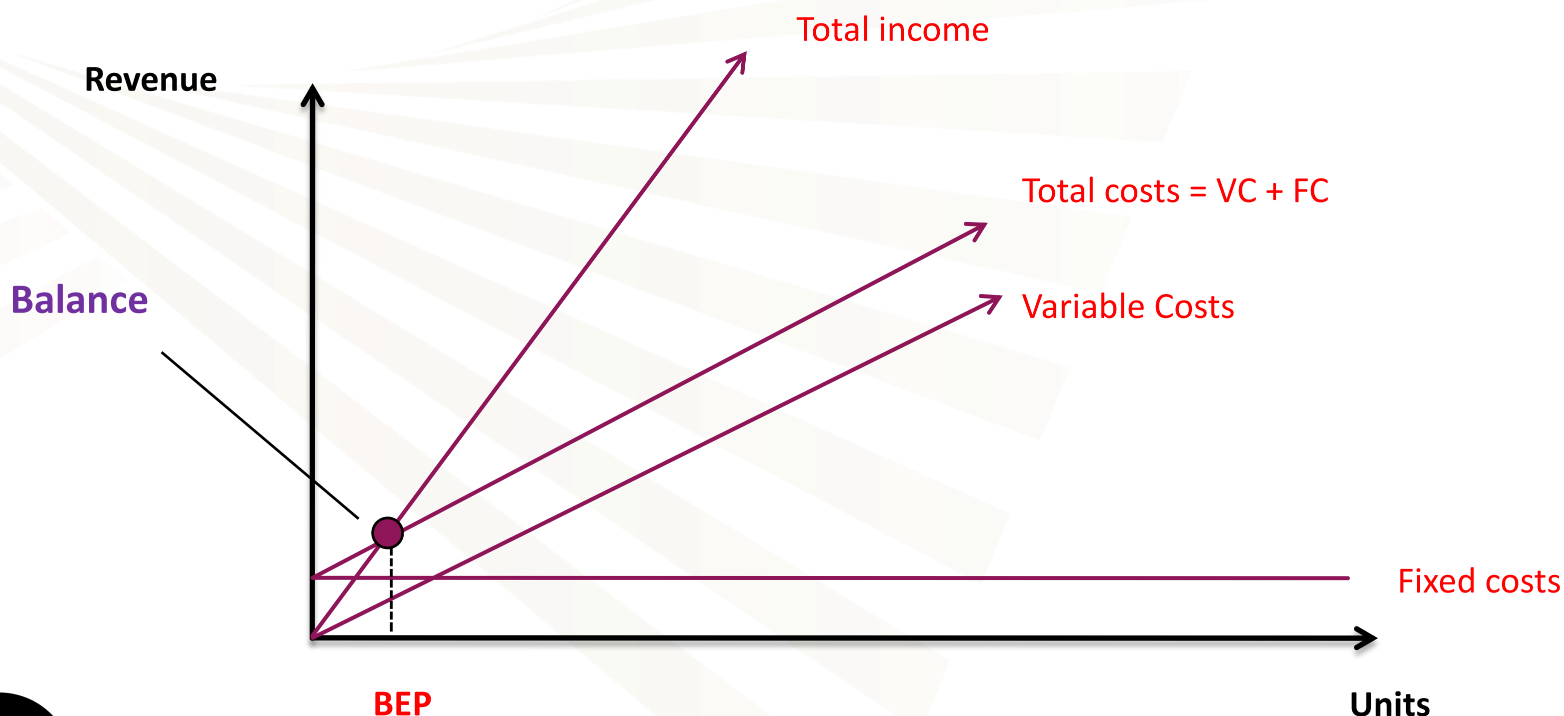
Total income = Total Costs



Utility is equal to zero.

There are losses
Total income < Total Costs

The Break-even point



Aims of the Break-even point

- Determine the level of production in which the company covers its total costs.
- Make the analysis marginal to determine the profit or loss that obtains by changes in the level of production.
- Serve of support for the analysis of budgets and help in the process of planning and control.

Formula of the Break-Event Point

- With this method knows those that units of an alone product has to sell to be in equilibrium (Incomes=Costs).

$$\text{Break-even point (in units)} = \frac{\text{Fixed Costs}}{\text{Price per unit - Variable Cost per unit}}$$

Break-Even and profitability wished

- If we add the profit wished to the Break-Even:

$$\text{Number of units to sell} = \frac{\text{Fixed Costs} + \text{Profitability wished}}{\text{Price per unit} - \text{Variable Cost per unit}}$$

COUNTABLE RESULT

Incomes – Expenses (Amortizations Included)

↓

GROSS PROFIT

↓

Finance incomes – Finance expenses

↓

PROFIT BEFORE TAXES

↓

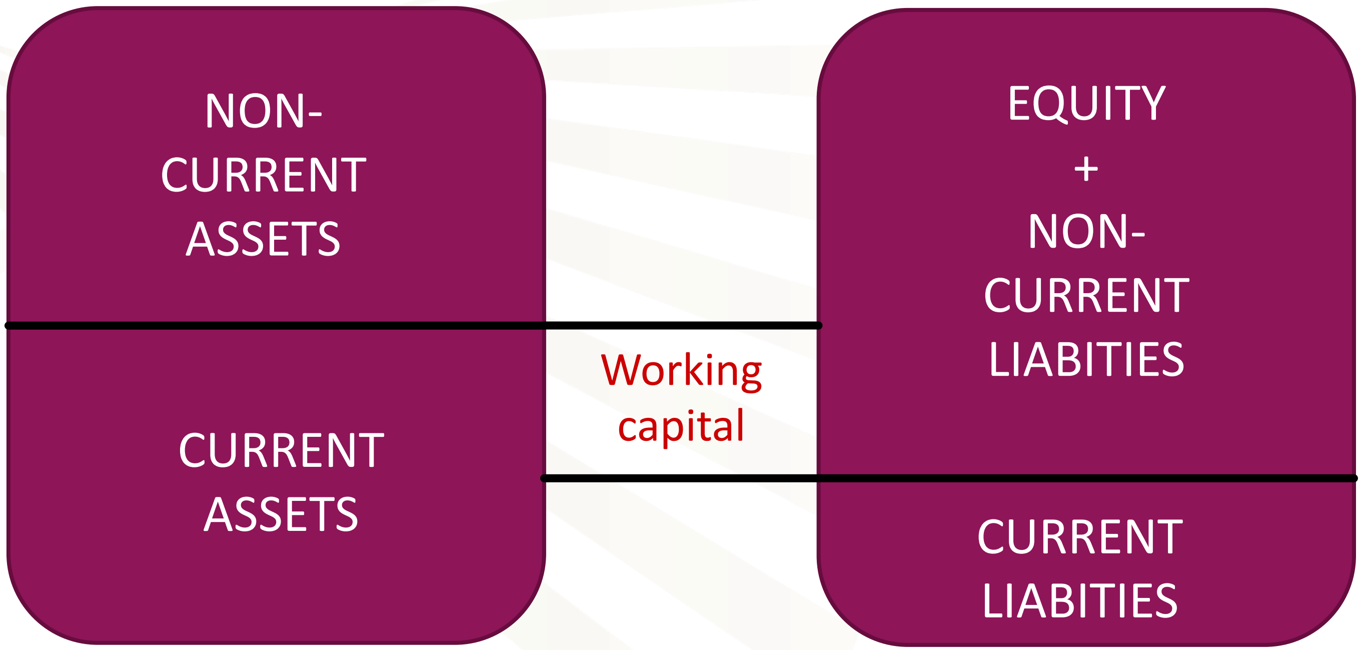
Taxes

↓

PROFIT AFTER INTEREST AND TAX OR PROFIT FOR THE PERIOD

5.3 Financial information of the business idea

WORKING CAPITAL



WORKING CAPITAL

- Working Capital: difference between a firm's current assets and current liabilities.

$$WC = CA - CL$$

If WC > 0 → The company can pay off its current liabilities with current assets and also have a stock of money
If WC = 0 → Current Assets are equal to Current liabilities, maybe the company can have problems to pay off
If WC < 0 → Current assets are lower to current liabilities