Financial Fundamentals

Small Business Financial Literacy Guide

Provided by Clarity Impact Finance

Created: March 2025

Financial Fundamentals

Understanding basic accounting concepts is essential for making informed business decisions. This section covers the fundamental building blocks of financial literacy.

Basic Accounting Concepts

* Assets: Resources owned by your business that have economic value
* Liabilities: Debts or obligations your business owes to others
* Equity: The residual interest in the assets after deducting liabilities
* Revenue: Income generated from business activities
* Expenses: Costs incurred to run your business

Understanding Financial Statements

Financial statements provide a snapshot of your business's financial health and performance.

* Income Statement: Shows revenue, expenses, and profit over a specific period
* Balance Sheet: Displays assets, liabilities, and equity at a point in time
* Cash Flow Statement: Tracks the flow of cash in and out of your business

Key Financial Ratios

|  |  |  |
| --- | --- | --- |
| **Ratio** | **Formula** | **What It Tells You** |
| Current Ratio | Current Assets ÷ Current Liabilities | Ability to pay short-term obligations |
| Debt-to-Equity | Total Liabilities ÷ Total Equity | Financial leverage and risk |
| Profit Margin | Net Income ÷ Revenue | Profitability efficiency |
| Inventory Turnover | Cost of Goods Sold ÷ Average Inventory | Sales and inventory management efficiency |

Cash Flow vs. Profit

Many business owners confuse profit with cash flow. A business can be profitable on paper but still run out of cash. Understanding this distinction is crucial for survival.

Cash Flow vs. Profit Example

A business invoices $10,000 for services in January (counted as revenue) but doesn't receive payment until March. Meanwhile, it must pay employees and suppliers in January and February. This business may show a profit for January but face a cash shortfall.

Action Steps

* Create or review your chart of accounts to ensure proper categorization
* Generate and review all three financial statements monthly
* Calculate key financial ratios quarterly and track trends
* Develop a cash flow projection for the next six months

Warning Signs to Watch For

* Consistent difficulty paying bills on time despite showing profits
* Rapidly increasing sales without corresponding cash increase
* Deteriorating financial ratios over multiple periods
* Inability to explain variations in financial statements

Additional Resources

• Financial Statement Template Pack

• Ratio Analysis Calculator

• Cash Flow Projection Tool