Building Financial Statements

Objectives

- While uncompetitive products, ill-suited strategies, and poorly performing teams influence failure, most companies fail due to:
  - ***Lack of MONEY***
  - ***Lack of TIME***
- Managing finances effectively can help you from running out of money prematurely and from spending money at the wrong time

Financial statements help…

- Investors understand
  - The profit potential of your firm
  - How much money you need to get there
    - On what timeline and for what purpose
- Entrepreneurs understand
  - Level of risk/reward for your venture
  - Value of your company (and in turn, your percent ownership) when it's time to raise capital for the venture

Financials statements typically exist in three general forms

- Income statement
  - Summarizes revenues and expenses
- Cash flow statement
  - Sum of retained earnings minus the deprecation provision made by the firm
- Balance sheet
  - Summarizes the assets, liabilities, and shareholders’ equity at a specific point in time

1. Income Statement Definitions

- Revenue (Sales)
  - Money paid to the company by customers in exchange for the sale of a product or service by the company
- Costs of Goods Sold (COGS)
  - Direct costs to produce each product or offer each service
  - For a product, all components and manufacturing costs
  - For a service, all costs of fulfillment; all labor costs.
  - Costs of goods sold are often variable as component and manufacturing costs drop as volume increases.

Key questions to consider

- **Revenue forecasts:** What can we sell, given the market, our pricing, and our capability?
- **COGS forecasts**: How will our costs of goods sold change as our revenues change?
- **SG&A forecasts**: What marketing/sales effort do we need to reach our revenue goals? What infrastructure do we need to support our business?
- *How much money do we need to accomplish growth?*

2. Statement of Cash Flows

- Reports cash receipts and payments over a period
- Lists all cash going into and out of the business
- Activities that impact cash are organized into three categories:
    1. Operating activities: Cash changes by operating the company
    2. Investing activities: Cash changes from buying/selling assets (equipment, building)
    3. Financing activities: Cash changes by borrowing funds, selling stock, paying dividends, reducing debt, etc.

Using the Cash Flow Statement

- The amount of money needed can be estimated by:

  - (Start-Up Expenses)

  - (Operating Expenses)

  + Revenues

  Cash Balance = Minimum Funding Required

3. Balance Sheet Definitions

Balance Sheet of XXX Corp. - 31 December of 201x (in thousand $)

Assets		Liabilities and Equity	
Current Assets (liquid in less than a year)	**Cash and equivalents** **Accounts receivable** **Inventories**	Current Liabilities (payable in less than a year)	**Accounts payable** **Accrued expenses** **Short term debt**
Fixed Assets	**Property, plant and equipment** (minus Depreciation)	Long-Term Liabilities	**Bank loans** **Bonds issued**
Other Assets	**Intangibles** (minus depreciation) **Investment securities**	Shareholders' Equity	**Common stock** **Additional paid-in capital** **Retained earnings**

Total Assets* = *Total Liabilities + Shareholder's Equity

Summary

- Financials statements are a valuable tool to both investors and entrepreneurs
- Critical to determine ***how*** much money you need ***when*** and for ***what*** purpose
- Quantifying the risk and reward is an early step to determining ***if*** to launch the venture