Finance in Small Business

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Contents

Financial Management

- Financial management helps an entrepreneur to
- i) **maximize use of financial resources**,
- ii) **evaluate new business opportunities**,
- iii) **measure or assess the factors affecting business performance**, and
- iv) **use financial information to make business**

Evaluating Financial Position

- The financial structure of a business is reflected in its assets, liabilities and equity.
- At any point in time, the assets liabilities and equity accounts form the *financial structure* of a business enterprise. These tend to change from one period to the next.
- A balance sheet is prepared to show the value of a business and how the funds are distributed.

Profit Making

- The financial structure of a business is changed by its profit making activities and is reflected in the *revenue and expense accounts*.
- The financial values exchanged are shown by the profit-and loss statements.
- **Revenue - Expenses = Profits**

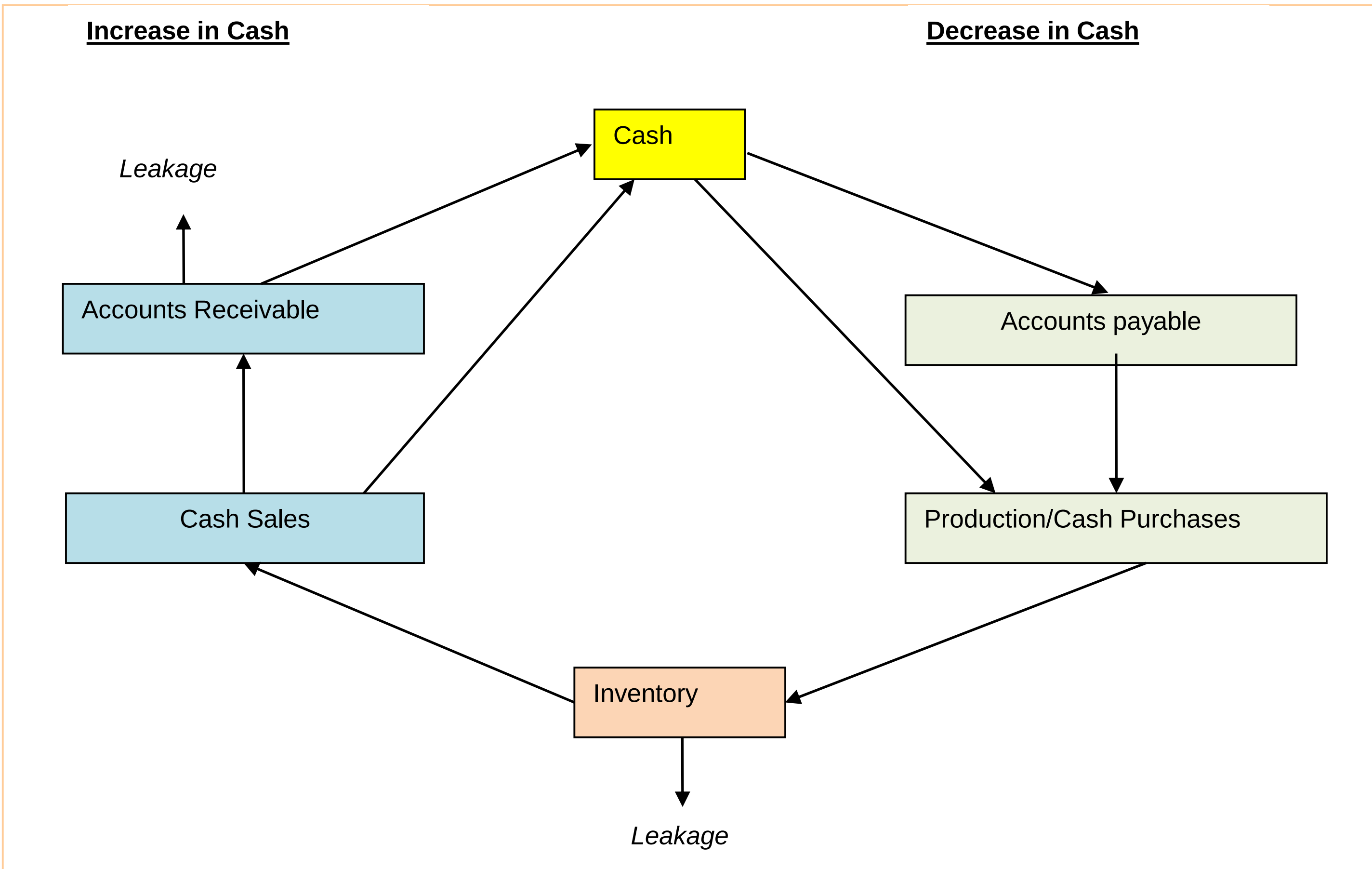
Managing Cash Flow

- **Cash mgt** involves **forecasting, collecting disbursing, investing and planning for cash** in the business.
- Cash is the lifeblood of a business – to meet various obligations such as paying suppliers, employees and taxes.
- Cash mgt is an acute problem for a rapidly growing company.
- There are **two steps in managing cash**:
- i) understanding the cash flow cycle – the time lag between paying suppliers and receiving payment from customers,
- ii) analyzing the cash flow cycle – look for ways to reduce the length of the time lag.

Entrepreneur in Cash Mgt

- ***cash finder*** – ensuring there is enough cash to pay all bills: an on going activity
- ***cash planner*** – making sure cash is used properly and efficiently; keeping track of cash, its availability and use
- ***cash distributor*** – control cash needed to pay bills, priority and timing of payments; this is essential to keeping business solvent
- ***cash collector*** – ensure customers pay bills on time; uncollected accounts drain the business's cash pool
- ***cash conserver*** – make sure business gets maximum value for money spent; spending cash so it will produce a good return for the company

Cash and Profits



Avoiding Cash Shortage

- Several techniques exist to avoid cash shortage in a business:
- **bartering** – the exchange of goods and services for other goods and services rather than cash
- **reducing overheads** by
  - i) periodically evaluating expenses,
  - ii) leasing instead of buying
  - iii) avoiding nonessential outlays –
  - iv) negotiating fixed loan payment to coincide with company's cash flow cycle,
  - v) buying used or reconditioned equipment
  - vi) hiring part-time employees
  - vii) controlling employee advances and loans
  - viii) check fraud
  - ix) switching to zero based budgeting
- **looking out for employee theft**
- **keeping the business plan current**
- **investing surplus cash**

Costs and Profits

- Import from BIT Entrep IV

Sources of Finances

- The principal sources of business finance are classified into two: *equity* and *debt.*
- Equity comprises the owner's contribution and retained profits.
- Debt is made up of long-term debt and short-term debt.

Selecting Sources

- **Factors to consider in selecting sources of finance**
  - ***Cost***: if the cost of the finance (interest charges +other costs of capital) is high, there will be low profits from the business.
  - ***Duration***: consider the nature of the financial requirement, whether it is short-term or long-term
  - ***Accessibility***: generally small companies have difficulty raising funds through share issues outside immediate circle of family and friends.
  - ***Gearing***: this is the ratio of debt to equity. Higher debt has the risk of meeting regular repayments of interest and principal. Need to balance equity and debt.
  - ***Term structure of interest rates***: relationship between interest charges for different maturity periods. Consider the rates with the time required to repay the loan.

Raising Required Funds

- ***Loan application form***
- ***Financial statements**:* the business balance sheet and income statement for the last three years.
- ***Strategic and financial plans**:* the lender may ask for an explanation of the projections
- ***Curriculum vitae**:* the lenders want to know who is running the business and know about the experiences and education
- ***Collateral security list:*** both business and personal that are available as collateral to secure a bank loan.
- ***Copies of articles of incorporation**:* evidence of the legal status of the business
- ***Contracts, leases and other legal obligations**:* all the significant legal obligations that can affect the ability to pay the loan.

Credit Key Elements

- ***Capacity (management):*** the ability of the borrower to repay
- ***Capital:*** the lender expects there is enough owners' equity or capital in the business to support the loan.
- ***Collateral:*** collateral is the secondary source of repayment. It can be in the any kind of asset including cash, accounts receivables inventory, equipment buildings and land.
- ***Character;*** track record of repaying bills on time. The lender may request credit reference to verify.
- ***Conditions:*** the lender considers the general economic and business conditions as well as the unique circumstances affecting the applicant.

Business Risk Management

- **Insurance addresses the risks a business runs** by virtue of its existence.
- The risks are:
  - death of an entrepreneur; fire destroying buildings;
  - **poor inventories**; **liability judgments for accidents**;
  - pilferage by customers or employees;
  - **embezzlement of funds; armed robbery**;
  - a court judgment awarding a settlement after bringing a product liability suit.

Family and Business

- Pay yourself a salary that that allows you to live comfortably. You need to keep contingency funds to cover family emergencies.
- Keep family and business finances separate.
- Be careful when employing family. The bottom line is: do not employ a family member. It will only bring confusion.
- Manage your extended family. You should realize that it is not possible to help every one all the time. There is a limit to how much you can help.
- This may sound un-Zambian. But if you value your business and your welfare you will make the right decision to **protect what is yours, for you and your immediate family.**

THANK YOU