Student workbook

Cl\_Finance

BSBESB403 Plan finances for new business ventures

BSBESB407 Manage finances for new business ventures

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Contents

[Get started 5](#_Toc189636349)

[What will I learn? 5](#_Toc189636350)

[Icon legend 8](#_Toc189636351)

[Lesson 1: Prepare and plan finances 9](#_Toc189636352)

[Overview 9](#_Toc189636353)

[Identify product and service delivery costs 9](#_Toc189636354)

[Set profit targets 16](#_Toc189636355)

[Perform a break-even analysis 31](#_Toc189636356)

[Choose a suitable pricing strategy 36](#_Toc189636357)

[Prepare a financial plan 40](#_Toc189636358)

[Identify working capital needs 41](#_Toc189636359)

[Prepare a profit and loss statement 43](#_Toc189636360)

[Prepare a projected profit statement 49](#_Toc189636361)

[Understand a balance sheet 52](#_Toc189636362)

[Prepare a cash flow statement 55](#_Toc189636363)

[Budget financial requirements 59](#_Toc189636364)

[Understand legal and tax requirements 60](#_Toc189636365)

[Prepare cash flow projections 62](#_Toc189636366)

[Prepare financing strategies 70](#_Toc189636367)

[Assess the cost of getting finance 75](#_Toc189636368)

[Assess financial strategies for future changes 79](#_Toc189636369)

[Create and manage credit policies 81](#_Toc189636370)

[Lesson 2: Manage finances 88](#_Toc189636371)

[Overview 88](#_Toc189636372)

[Communicate financial information to others 88](#_Toc189636373)

[Identify needs for non-current assets 91](#_Toc189636374)

[Identify capital investment needs 103](#_Toc189636375)

[Set budget targets to track financial performance 106](#_Toc189636376)

[Monitor financial performance using systems 113](#_Toc189636377)

[Evaluate how marketing and operations impact finances 116](#_Toc189636378)

[Assess financial ratios against industry benchmarks 119](#_Toc189636379)

[Adopt new technologies to improve profits 130](#_Toc189636380)

[Answers and feedback 134](#_Toc189636381)

[Lesson 1 134](#_Toc189636382)

[Lesson 2 141](#_Toc189636383)

[References and attributions 144](#_Toc189636384)

[References 144](#_Toc189636385)

[Image attributions 145](#_Toc189636386)

[Appendix: Links 146](#_Toc189636387)

**Get started**

## What will I learn?

This workbook covers the units of competency: BSBESB403 Plan finances for new business ventures and BSBESB407 Manage finances for new business ventures.

Successfully completing this unit will give you the skills and knowledge to prepare, plan and manage finances for new business ventures.

In this workbook, you will learn to:

* prepare and plan finances
* monitor finances.

Each lesson includes opportunities to check your progress and understanding as well as practice activities that will prepare you for the formal assessments. Answers and feedback for the activities are at the end of this document.

There are 2 lessons to complete within this workbook. They are:

1. Prepare and plan finances
2. Manage finances

If you are using a printed version of this workbook, links and URLs are in a table at the end. Type the URL into your browser to go to the link.

To complete this unit, we have put together some resources to assist in your learning journey. These include:

* A **Business directory and glossary**, which provides essential links, terms and definitions to build your understanding of business concepts.
* An introduction to **Artificial intelligence** (AI), with links to tools you can use and the responsible use of AI.
* A guideline to the **Business venture** you should use throughout the unit.

Reviewing these resources will enhance your knowledge and prepare you for success in this unit.

#### Business directory and glossary

A [Business directory and glossary (pdf)](https://share.tafensw.edu.au/share/items/44493bae-4b5e-4254-b28d-6d714656dfb6/0/?attachment.uuid=e7433cba-0f03-4eac-b72b-0faafa5f1076) is available. This document has been created to assist you in your journey of entrepreneurship and small business. You will find links to useful websites and resources that provide assistance to business owners. This document also includes a glossary of business terms.

#### Artificial intelligence

Throughout this unit, you may have opportunities to use and experiment with Artificial Intelligence (AI) and Generative AI. You can access Microsoft Copilot through TAFE NSW’s Microsoft licence. You can also access Adobe Creative Cloud, including products that use generative AI, such as Adobe Firefly and Adobe Express. TAFE NSW students have access to Adobe Creative Cloud on campus and can log into the Creative Cloud Portal with their TAFE NSW credentials on their own device.

Visit the TAFE NSW [Technology for Learning](https://tafensw.libguides.com/technology) library guide for TAFE students for further information and links. For further instruction on how to use AI responsibly, you can utilise the TAFE NSW [Researching and Referencing: Generative AI](https://tafensw.libguides.com/research/artificial) library guide.

#### A business venture

The learning activities in this unit are designed to support you through your learning journey and help you to gain the required knowledge and skills. In completing the learning activities, you can choose to either:

Use **your own business or business idea**: If you already run a business or have a business idea you want to develop, you can use that for the learning activities. Make sure your idea is clearly defined and fits the project requirements. You might need to use business policies and procedures to complete the tasks. If your business doesn’t have the necessary policies and procedures you can use the documents available on the **Azure Beach Surf and Skate** [**intranet**](https://share.tafensw.edu.au/share/items/1c89b5bb-2698-4ced-91d8-29a58efbaab2/0/?attachment.uuid=619dbebb-d353-4953-8e7a-775c44521322).

**OR**

Use the **TAFE NSW simulated organisation, Azure Beach Surf and Skate**: If you don’t have your own existing business or business idea, you can use [**Azure Beach Surf and Skate**](https://share.tafensw.edu.au/share/items/1c89b5bb-2698-4ced-91d8-29a58efbaab2/0/?attachment.uuid=74f8070a-c4c0-4c14-a007-aedc47689889).

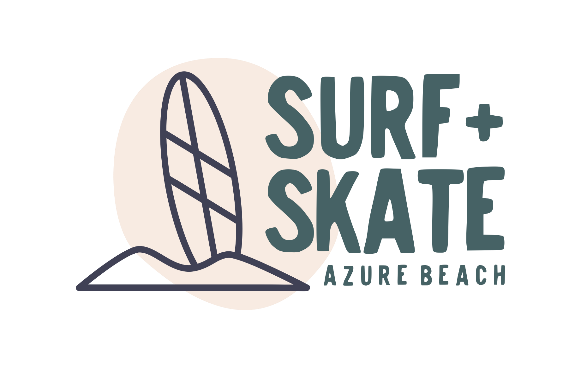


Figure 1: ©TAFE NSW 2025

Azure Beach Surf and Skate provides a simulated environment that reflects a real business setting and real-life work tasks. It is a local retail and service business, selling a range of surfboards, skateboards, apparel and accessories. It also offers surf lessons and skateboarding workshops. It serves local enthusiasts and tourists searching for high-quality gear and services. You can find all the details and documents you need on their website and intranet.

## Icon legend

Table 1: Icons

|  |  |
| --- | --- |
| Icon | Description |
|  | **Practice activity**  Complete these learning activities as they will help you to gain the knowledge and skills you need to complete your assessments. |
|  | **Resources**  Review resources that will enhance your learning and help you with your assessments. |
|  | **Video or audio**  Review video or audio for task demonstrations and to gain a deeper understanding of job roles and concepts. If you are using a printed version, you may need to type the URL into your browser. |
|  | **Self-check**  Complete these activities to check your learning progress. They help you identify where you may need to go back and revise your learning. Mark off the tasks you have learned. |

**Lesson 1:**Prepare and plan finances

## Overview

Finance is the backbone of all business decisions and operations. Whether a business seeks to establish its operations, train its staff or undertake new marketing strategies, it will need adequate finances to fund its business goals and objectives. Financial management refers to preparing, planning and controlling your business’s financial activities to ensure that you use funds effectively. It is important you learn how to prepare and plan for your finances accordingly so that your business is in good financial health for the long term.

In this lesson, you will learn to:

* identify product and service delivery costs and set profit targets.
* calculate charge-out rates and unit prices.
* perform a break-even analysis and choose a suitable pricing strategy.
* prepare a financial plan, including projected profit and loss statements and cash flow projections.
* identify working capital needs and prepare financing strategies.
* understand legal and tax requirements.
* assess the cost of getting finance and financial strategies for future changes
* create and manage credit policies.

## Identify product and service delivery costs

All businesses incur costs in delivering a product or service. For example, a physical retailer needs to pay for rent. A sole trading business that employs multiple people will need to pay direct labour costs to their employees. A product may also take additional material costs to make, package and deliver. It is essential to understand the different types of costs for your business as they affect your financial management and decision-making processes.

### Types of costs

Businesses can categorise their costs in multiple ways. The 2 main categories of costs are fixed costs and variable costs.

#### Fixed costs

Fixed costs are expenses that remain constant regardless of the level of production or sales – for example, whether you produce zero units or 100 units, your business will pay the same amount for rent each month. Common examples of fixed costs include:

* **Rent** – Payments for office or production space that remain unchanged over time.
* **Salaries** – Wages for permanent staff not directly tied to production levels. If you are the only person under a sole trader business, you cannot include yourself in a payroll system and thus do not need to prepare a salary. Sole traders and partnerships pay themselves by taking money from the business as drawings.
* **Insurance** – Premiums that must be paid regardless of business performance.
* **Utilities** – Basic utility payments such as rent, water, insurance and maintenance fees and internet connection costs that do not vary with production volume. Some utilities such as water, electricity and internet or broadband connection costs can be considered mixed costs.
* **Depreciation** – Depreciation is an accounting process used to reflect the reduction of an asset's value from wear and tear. Depreciation is usually a fixed cost (under the straight-line method) as businesses assume the asset's value decreases uniformly over its effective life (Australian Taxation Office, 2024). However, there can be other accounting methods, such as diminishing value, which assumes the asset decreases more in the earlier years of its life than later – this may turn the cost into a mixed cost.
* **Software cost** – A startup or monthly fee to the software platform that hosts your e-commerce website or that you use for business purposes.

E-commerce and physical businesses can also incur fixed costs differently. For example, e-commerce and online businesses can incur additional software costs to use a license or website. They may also forgo any rent.

**Can a fixed cost change?**

Usually, a fixed cost remains fixed even if there are slight fluctuations or temporary changes. Imagine a small retail business such as EcoGlow Pty Ltd wishing to scale from a small 50 square metres store to a larger 80 square metres store to improve productivity. The rent and utilities, in this case, would increase as a one-off event with this upscaling. However, the expenses are considered fixed costs because the business will pay them consistently later.

Understanding fixed costs is crucial because they represent your business's baseline operating expenses, regardless of revenue fluctuations.

**Home-based businesses and fixed costs**

If you use your home to operate your business, you may be eligible to claim work-from-home expenses from the Australian Taxation Office (ATO). To qualify for this, you must work at home full-time as part of your business role and have incurred expenses related to operating your business while at home.

These expenses can include office furniture, internet plans, electricity and other related expenses. The ATO website has provided resources for 2 key methods for calculating tax deductions.

 Resources

For more information on your working-from-home tax deductions and calculation methods, you can refer to the [Working from home expenses](https://www.ato.gov.au/individuals-and-families/income-deductions-offsets-and-records/deductions-you-can-claim/working-from-home-expenses) from the Australian Taxation Office.

#### Variable costs

In contrast, variable costs fluctuate directly with changes in production output or sales volume. As a business produces more goods or services, these costs increase. They can also decrease when production levels or sales volumes drop. Common examples include:

* **Direct costs** – are expenses that can be directly traced to producing specific goods or services, such as raw materials or direct labour.
* **Indirect costs** – support overall business operations but do not contribute directly to creating goods or services such as marketing, utility expenses or purchasing office supplies.

Understanding the distinctions between direct and indirect costs and fixed and variable costs is crucial for business owners to manage their finances effectively.

 Video

Review the video [Fixed and variable cost examples](https://www.linkedin.com/learning/running-a-profitable-business-calculating-breakeven/fixed-and-variable-cost-examples-14754114?u=57684225) (LinkedIn Learning, 3:03 min) to learn more about fixed and variable cost examples in practical terms.

This LinkedIn Learning video will open in a new tab within your browser. You can access the full video by logging in with your TAFE NSW username and password. You can access a transcript of the video on the transcript tab within LinkedIn Learning. When you're finished, simply close the tab and return to your course.

**Video summary**

* You can distinguish between a fixed and variable mindset by considering whether they change directly with the level of activity required in selling or servicing.
* Fixed costs are those that do not change markedly with the level of activity, such as a supervisor’s salary or the cost of movie projectors in a theatre.
* Variable costs vary directly with the activity level, such as production costs for snacks in a movie theatre or ice cream in an ice cream shop.

#### Mixed costs

Sometimes, a cost can be mixed. A mixed cost is a type of cost that can include fixed and variable components; in other words, there is a component of the cost that does not change with the activity level and a component that does. Examples of mixed costs can include some utility fees (for example, electricity or internet), sales commissions, bonuses, depreciation and advertising expenses.

Whether a cost is mixed or fixed depends largely on the business’s contract agreement with external parties.

Table 2: Examples of mixed costs

|  |  |
| --- | --- |
| Mixed cost | Example |
| Energy expenditures for utilities such as electricity and water | Energy expenditures for water and electricity consumption can be mixed depending on the business’s contract or arrangement.  For example, a business’s monthly or quarterly electricity bill usually includes a fixed base charge and a variable charge rate for any additional levels of usage. |
| Broadband or internet connection fees | A business might pay a base fee for internet service (fixed) plus additional charges for data usage (variable). |
| Bonuses or commission-based pay | Bonuses and commissions are mixed because they combine the fixed cost of an employee’s salary with the variable component of additional pay.  Bonuses are generally performance-based, measured through metrics such as the number of sales targets an employee has reached or the number of project completions.  Similarly, commissions can be based on the number of sales targets an employee has hit. |
| Depreciation expenses | Depreciation is an accounting process used to reflect an asset's value reduction as it is used and worn out. Under the straight-line method, depreciation is usually a fixed cost but can be mixed if the business uses the diminishing value method.  For this workbook, depreciation is assumed to be a fixed cost. |
| Advertising costs | Advertising costs can be a mixed cost depending on the business’s overall strategy. Certain advertising costs, such as the lease for billboards, are fixed under contractual agreements.  Other advertising costs can be variable. Digital marketing campaigns can fluctuate based on performance metrics or timing. Pay-per-click (PPC) advertising is an example of a variable cost since businesses pay for each click their advertisements receive. |

### Production costs

Production costs include all the **direct** and **indirect expenses** businesses incur when producing a product or service. Labour, raw materials, consumable production supplies and general overhead are some of the expenses that can contribute to production costs.

Here are some common production costs in product-based businesses:

Table 3: Common production costs

|  |  |  |
| --- | --- | --- |
| Cost | Description | Type of cost |
| Raw materials | Materials needed to create the final product, such as steel or wood. | Variable |
| Production labour | Wages for workers directly involved in the production of the product or service. | Variable |
| Rent expenditure – facilities | Cost for the business to occupy a property. This can include storage, retail and office spaces. | Fixed |
| Maintenance costs | Regular costs for maintaining machinery and equipment. | Fixed |
| Electricity expenditure – facilities | The cost of powering your retail space or production equipment. Electric bills usually have a fixed base charge for a certain quantity of electricity consumed and an additional charge rate for extra usage. | Mixed |
| Equipment depreciation costs | Costs of wear and tear in using machinery, vehicles and other equipment. | Mixed |

### Calculate production costs

This formula is used to calculate total production costs:

Total production cost = Direct materials + Production labour + Production overheads (indirect costs such as energy, rent, maintenance)

**Case scenario example:**

Suppose your small carpentry design business plans to produce custom wooden furniture. You have estimated your direct materials to be $3,000 for the wood, screws and varnish. You have estimated your direct labour to be $2,000 for carpenters on your staff and you have estimated production overhead to be $1,000 for rent and utilities.

Total production cost = $3,000 + $2,000 + $1,000 = $6,000

### Delivery costs

Delivery costs refer to the expenses incurred when transporting goods from one location to another. These costs vary based on several factors, including the shipping method, distance, weight and package dimensions. If you have a retail business, you will likely have delivery costs.

Here are examples of standard delivery costs and their descriptions and categorisation:

Table 4: Common delivery costs

|  |  |  |
| --- | --- | --- |
| Cost | Description | Category |
| Shipping fees | Charges from carriers based on weight and distance such as Australia Post and other couriers | Variable |
| Packaging costs | Expenses for materials used to package products for shipment, such as boxes and bubble wrap | Variable |
| Handling fees | Costs associated with loading and unloading goods at warehouses or during transit | Variable |
| Insurance | Coverage against loss or damage during transit | Variable |
| Delivery personnel | Wages for staff involved in the delivery process such as drivers and warehouse staff | Variable |

### Importance of calculating your business costs

Cost control is a fundamental process in financial management in which you find and reduce unnecessary business costs for financial and other business goals. Understanding how much and where your costs are accumulating will also help you set profit targets – in other words, plan out clear goals to help you maximise your earnings.

Accounting software such as MYOB or Xero has streamlined the process of calculating and reporting production costs. Understanding the different categories of costs is helpful for cost control purposes and maximising profitability.

## Set profit targets

In accounting and finance, profit is the net income your business has after paying for all business expenses. For small businesses, it is money you can either keep or reinvest back into the business. To develop any financial plan, you need to establish profit targets. Planning helps businesses work out the capacity at which they need to operate to achieve goals.

### Set a profit target

A profit target (or profit goal) is the amount of money needed to meet a set of predetermined commitments or the owner's desired returns. By identifying a profit target, you create a benchmark for your strategies to achieve.

To set a profit target, you will need to consider:

* costs (fixed and variable)
* owner's annual income
* operating expenses (fixed and variable)
* return on borrowed capital is an adequate return on the capital you have invested, at least equal to long-term bank interest as well as an additional return based on the level of risk
* return for risk is an adequate return on the capital invested based on associated risks, for example, a very speculative business venture would expect a high return if proven successful
* return for future growth is an adequate return on the capital invested based on associated risks, for example a very speculative business venture would expect a high return if proven successful.

### Calculate margins and markups

As you begin to understand your costs and profit goals, you will need to know how much revenue your product needs to make to cover them. Understanding your revenue helps the business set its product or service prices appropriately. In this section, you will examine profit margins, markups and charge-out rates to help prepare your products and services for effective pricing strategies.

### Profit margin

A profit margin is one of the most critical indicators of profit. It indicates the profitability of a service, product or business. It's the difference between what the service, product or business costs and the amount of money you receive for it. Profit margins are usually expressed as a percentage.

When setting profit margins, you should estimate your revenue to determine your profit margin. Your revenue will be used to make further calculations when determining your hourly charge-out rate or the selling price of products.

There are 3 key types of profit margins:

* **Gross profit margin** – Measures the percentage of revenue that exceeds the cost of goods sold (COGS). It indicates how efficiently a business produces its goods or services relative to its sales.

Costs of goods sold are direct costs associated with producing a good or service. This includes material costs, packaging, direct labour and any overheads directly tied up to the production.

* **Operating profit margin** – Accounts for all operating expenses, including COGS and other overhead costs such as salaries, rent and utilities. It reflects the efficiency of a business in managing its operational costs.
* **Net profit margin** – The most comprehensive measure of profitability, as it considers all expenses, including COGS, operating expenses, interest, taxes and other non-operating costs.

### Gross profit margin

This margin helps small business owners understand how much money remains after covering direct production costs. A higher gross profit margin suggests better pricing strategies or lower production costs, which can be crucial for maintaining profitability. You can calculate gross profit margin using the given formula:

**Note that net revenue refers to your business's sales revenue after accounting for expenses such as returns, discounts and other price amendments. These expenses could arise from instances where customers receive damaged goods or late deliveries and want compensation.**

**Scenario example:** Imagine you are a local bakery owner who wants to calculate your bakery's gross profit margin in 12 months.

Total net revenue = $100,000

Cost of goods sold (COGS) = $40,000 (includes flour, yeast and other direct ingredients)

**Calculation:**

Gross profit margin (%) = [(Total revenue – Cost of goods sold (COGS)) ÷ Total revenue] x 100

Gross profit margin = [(100,000 – 40,000) ÷ 100,000) x 100

= (60,000 ÷ 100,000) x 100

= 60%

A 60% gross profit margin is good because it indicates that the bakery is making 60% of its revenue after covering its production costs. Like any industry, understanding your ideal gross profit margin can depend on industry benchmarks.

 Resources

For further information on how you can compare your business’ profit margin against other small businesses in your industry, refer to the ATO’s website page [Compare your business now](https://www.ato.gov.au/businesses-and-organisations/income-deductions-and-concessions/small-business-benchmarks/compare-your-business-now).

### Operating profit margin

Operating profit margin measures how well a business is performing in its core operations, excluding non-operating income and expenses. It is helpful for identifying areas where operational efficiencies can be improved.

The formula is:

**Your operating profit is your sales revenue minus your cost of goods sold (total production costs) and your operating expenses. Your operating expenses are expenses that are not directly tied to the cost of producing a good or service but are essential to running your business. Your operating expenses will include all fixed and variable expenses, including (but not limited to) rent, utilities, marketing, salaries, technology, legal and administration costs.**

**Scenario example: Now imagine you are an online clothing retailer owner who uses an e-commerce website.**

**Total net revenue = $500,000**

**COGS = $300,000**

**Operating expenses = $100,000 (including utilities, marketing, salaries, e-commerce software expenses and home office occupancy expenses)**

**Your operating profit = $500,000 – ($300,000 + $100,000)**

**= $100,000**

**Calculation for margin:**

**Operating profit margin (%) = (Operating profit ÷ net revenue) x 100**

**Operating profit margin = ($100,000 ÷ $500,000) x 100**

**= 20%**

**A 20% operating profit margin suggests that the business keeps 20% of its net revenue after covering both its production costs and other operating expenses.**

### ****Net profit margin****

**This margin represents a business's actual profit** **after all expenses have been deducted from revenue. Unlike the operating profit margin, the net profit margin includes factoring in non-operation expenses such as interest expenses from loans and taxes. It is often called the ‘bottom line’ and is critical for assessing a business's overall financial health and viability. The formula for net profit margin is:**

**Your net profit is your total revenue minus your total expenses. In other words, it is your operating profit minus any tax, interest or non-operational expenses.**

**Scenario example: Now imagine you are a small coffee shop owner and want to calculate your net profit margin:**

**Total net revenue = $200,000 (from coffee sales, deliveries less any price reductions for late deliveries)**

**Total expenses = $160,000 (including COGS, operating expenses and income tax expenses)**

**Net profit = $200,000 – $160,000**

**= $40,000**

**Calculation for margin:**

**Net profit margin (%) = (Net profit ÷ net revenue) x 100**

**Net profit margin = ($40,000 ÷ $200,000) x 100**

**= 20%**

**A 20% net profit margin suggests the coffee shop keeps 20% of its net revenue after covering total expenses. Another way to interpret it is that the coffee shop retains 20c of profit for every $1 earned in revenue.**

**What is the ideal profit margin?**

When you need to consider what your optimal profit margin is, you must consider your industry. Profit margins can be dependent on the industry in which a business operates; it is ineffective to compare an online clothing business to a coffee shop or bakery, for instance, because an online business will inherently have fewer inventory costs compared to a business dealing with perishable goods.

Understanding industry-specific profit margins is essential for small business owners in Australia to make informed pricing decisions and manage operational costs effectively. You can access data research companies such as Money.com.au’s [We give a buck®](https://www.money.com.au/) or the [Australian Bureau of Statistics](https://www.abs.gov.au/) to find up-to-date Australian business statistics surrounding profit margins and industry profitability (Money, 2025).

 Video

Review the video [Profitability and earnings ratios: Margins](https://www.linkedin.com/learning/accounting-for-non-accountants/profitability-and-earnings-ratios-margins?u=1504) (LinkedIn Learning, 5:45 min) for more information on calculating your product’s gross profit and net profit margin.

This LinkedIn Learning video will open in a new tab within your browser. You can access the full video by logging in with your TAFE NSW username and password. You can access a transcript of the video on the transcript tab within LinkedIn Learning. When you're finished, simply close the tab and return to your course.

**Video summary**

* Managing a business's profitability can be likened to coaching a basketball team, where balancing sales (offence) and costs or expenses (defence) is crucial.
* The video introduces 2 key profitability metrics – gross profit margin and net profit margin. Gross profit margin is calculated by dividing gross profit by sales, while the net profit margin is derived from net income divided by sales.
* Analysing changes in these margins over time is essential for understanding the factors that influence them, such as supplier costs or sales revenue fluctuations.

 Resources

For an indication of where your industry benchmark sits for profit margins, you can refer to the webpage [Australian Business Statistics 2025](https://www.money.com.au/research/australian-business-statistics).

### Set the right price

Your pricing strategy is one of the most important business decisions you'll make. Setting prices too high or too low will have a considerable impact on your business's growth. Because of this, you need to carefully consider your business's pricing strategy based on your costs and profit margins.

#### Cost, price and value

The terms 'cost', 'price' and 'value' are often used interchangeably but it's important to recognise the differences between them.

* **Cost** – refers to the net amount of money you spend to produce your product or service.
* **Price** – refers to the financial reward you receive for providing the product or service or what the customer pays.
* **Value** – refers to what the customer believes the product or service is worth to them. This may be different to the price they pay for it.

**Example of the differences in cost, price and value as a customer:**

Imagine buying a storefront banner to showcase your business's name and promote more foot traffic into your retail store. The banner requires a total production cost of $1,000 to assemble (including the cost of the material, ink and labour of printing your business branding). The signage business charges you a retail price of $1,200.

Now imagine that you have a very small store near the centre of the central business district, where foot traffic is high. Your new storefront banner increases your business's visibility and presence and customers approach the business more frequently every month afterwards. This phenomenon is the value you pay for but how do you measure it? Unlike price and cost, value can be subjective to each customer.

### Markup

Markup refers to a product or service's retail or selling price minus its costs. Markup is often expressed as a percentage. This markup percentage refers to the proportion of the selling price that doesn't include variable costs to make the product or service.

In other words, it represents the additional amount added to the cost of goods sold (COGS) to determine the selling price. The formula for calculating your markup is:

It is important to note that the markup percentage is calculated differently from the profit margin percentage when calculating the markup percentage.

Your markup and profit margin involve the same financial values (selling price, cost of goods) but are 2 different financial metrics. Your profit margin is calculated based on the selling price of your product, while your markup is calculated based on the cost of your product.

**Scenario example:** Imagine EcoGlow Pty Ltd, a small company that specialises in candle-making, selling a new premium line of luxury candles.

The new candle costs $40 to produce and is sold for $60, the markup is calculated as follows:

Markup = Selling price – Cost

Markup = $60 – $40

= $20

To calculate the markup percentage = (Markup ÷ Cost) x 100

= ($20 ÷ $40) x 100

= 50%

The 50% markup percentage provides insight into how much more customers are paying than what it costs to produce the item. A higher markup percentage can indicate a premium pricing strategy or a unique product offering.

So, while markup and profit margin indicate profitability, they do so from different perspectives.

Table 5: Summary of the differences between profit margin and markup

|  |  |
| --- | --- |
| Markup | Profit margin |
| Markup is the amount added to a product or service’s cost to determine its selling price. Markup is calculated as a percentage:  (Selling price – Cost of goods) / Cost of goods | Profit margin is the percentage of sales revenue that remains after deducting the cost of goods. Profit margin is also calculated as a percentage:  (Selling price – Cost of goods / Selling price) x 100 |
| Calculated based on the cost of the product | Based on the selling price of the product |
| Indicates how much more the selling price is compared to the cost price | Indicates the product profitability in relation to sales generated |
| Used to assess pricing decisions and cost control purposes | Used to assess the business’s overall profitability from sales of products and whether its pricing strategy covers its production costs |

 Video

Review the video [Markup vs Margin](https://www.youtube.com/watch?v=tKpJJWL6Ze8) (YouTube, 1:38 min) to learn the difference between markup percentages and profit margins through a visual example.

**Video summary**

* The video summarises the difference between markup and margin in simple terms. Markup is the percentage by which you bumped up the prices.
* Margin tells you what percentage of a sale profit is.
* Your markup percentage is always larger than your margin percentage.

### Calculate charge-out rates and unit prices

Calculating prices based on costs, profit margins and profit targets is crucial to ensuring business owners set prices that generate net profit, including all labour inputs. Depending on if you are selling a product or service, you will break down your cost and profit targets into either of these 2 categories:

* labour pricing
* unit pricing.

The price you set for labour on the services you deliver or the products you sell is essential to ensure you meet your expenses and make a profit.

#### Labour price

If your business model involves providing services, calculating a charge-out rate for labour is essential. This rate determines how much you will charge clients for each hour of work your team performs.

Calculating a charge-out rate for labour involves determining how much to charge clients for each hour of work performed. This method ensures that all costs associated with providing labour are covered while also achieving a desired profit margin.

#### Calculation steps

There are 7 steps to calculate your charge-out rate for labour.

Table 6: Charge-out rate for a service

|  |  |  |
| --- | --- | --- |
| Step | Description | Example |
| Step 1: Determine annual labour cost | Calculate the total annual cost of all employees involved in the service, including salaries, superannuation, workers' compensation and other benefits. | If you have one employee (Lawn Care Specialist) with a salary of $50,000 and benefits of $10,000, the total annual cost is $60,000. |
| Step 2: Determine labour availability | Determine how many hours your employees are available to work in a year after accounting for holidays and sick leave. | We assume in a working year that there are 40 hours a week and 52 weeks a year. 40 hours x 52 weeks = 2080 hours.  We also assume the employee will have 10 days of holiday leave and 5 days of sick leave. (10 + 5) x 8 = 120 hours of total leave.  2080 – 120 = 1,960 total labour hours available. |
| Step 3: Calculate billable time | Assess your employees' average billability.  This is the percentage of time that can be charged to clients. Downtime may be due to travel, administration or the next client set-up, for instance. | If your Lawn Care Specialist can bill for 75% of their time: Billable time = 0.75 x total hours per week.  Your billable time = 1,960 x 0.75 = 1,470 |
| Step 4: Establish minimum gross profit | Establish your minimum gross profit target to cover overheads and achieve your desired net profit goal. | If your net profit goal is $30,000 and projected overhead costs are $20,000, your minimum gross profit target is $50,000. |
| Step 5: Determine labour gross profit target | Determine how much gross profit your labour needs to generate to meet your minimum gross profit target. | If projected material costs are $15,000 with a markup of 30% ($4,500 gross profit), then required Labour gross profit = $50,000 – $4,500 = $45,500. |
| Step 6: Calculate minimum labour margin | Calculate the gross margin needed to achieve your required labour gross profit based on total available hours and costs. | If total worker costs are $60,000 and required Labour gross profit is $45,500 with total available hours of 1,470:  Minimum labour margin = |
| Step 7: Calculate minimum charge-out rate for labour | Your minimum charge-out rate for labour is the amount you need to charge to cover your gross profit margin. | For the lawn care specialist:  Minimum labour rate = $71.77 per hour |

This structured approach helps set competitive pricing and ensures sustainability and profitability in your business operations.

 Practice activity

### Activity 1: Charge-out rate for Perfect Snaps

Download the [Cl\_Finance\_TL\_Appx\_FnclTmplts (xlsx)](https://share.tafensw.edu.au/share/items/389866a6-ab4f-4beb-aa28-969d348ab791/0/?attachment.uuid=1cb311a4-872d-4a4c-917b-d567252cad2d) document to assist with your calculations. Use the tab **Activity 1**. Save the spreadsheet to your device, as it will be used in various activities throughout the lessons. The tabs at the bottom of the spreadsheet are labelled for each activity.

**Activity scenario:** Clara is the owner of a sole trading business called Perfect Snaps, where she and another employee, Anna, provide photography services for special occasions. Anna recently did a vocational training course in wedding photography, which Clara wants to add to their services. However, Clara does not know how much she should charge their clients.

When reviewing her costs and payroll in Xero, she notes that:

Anna’s yearly salary (including superannuation) is $65,000.

Anna is available to work 1,980 hours a year. However, Anna only dedicates 75% of her time to her clients. The other 25% is spent on maintaining her camera equipment and helping Clara with marketing campaigns.

Clara has written these cost details in a table.

Table 7: Perfect Snaps cost details

|  |  |
| --- | --- |
| Item | Amount |
| Anna’s yearly salary (including superannuation) | $65,000 |
| Anna’s total availability to work | 1,980 hours a year |
| Percentage of billable time that Anna dedicates to clients | 75% |
| Anna’s total billable time (in hours) | Blank cell |

1. Calculate Anna’s total billable time for the year in hours.

Perfect Snap’s minimum gross profit target for the year is $20,000, which ensures profitability while covering all operating expenses.

However, Clara also notes that, as a service-based business, there are additional material and labour costs in producing its services, such as the cost of setting up camera equipment at the wedding venue and travel expenses to the wedding venue. The total material costs for the year are projected to be $5,000, which needs to be accounted for in the minimum gross profit target.

Table 8: Perfect Snaps cost details

|  |  |
| --- | --- |
| Item | Amount |
| Total minimum gross profit target for the year | $20,000 |
| Total material costs for the year | $5,000 |
| Total labour gross profit margin | Blank cell |

1. Calculate Perfect Snap’s total labour gross profit margin for the year.
2. Calculate the minimum charge-out rate for Anna. Round your answer to the nearest 2 decimal places.

 Video

Review the video [How much does an hour of tradesmen's labor cost?](https://www.youtube.com/watch?v=oVEitVj3NJA) (YouTube, 14:17 min) to learn more on how you can charge your labour charge-out rates.

**Video summary**

* The cost of labour per hour is higher than it seems because employees aren't chargeable for all the hours they’re paid. Factors like holidays, sick leave, training and non-chargeable time reduce actual chargeable hours.
* Pricing must factor in overheads, such as office administration, marketing, facilities and non-field staff salaries.
* Understanding true costs and overheads gives businesses the confidence to price services correctly. This understanding is critical given rising material and wage costs.

 Resources

Your business may have more cost factors that you need to consider in your charge-out rates. For an efficient method of calculating real-world hourly rates, you can use Finder’s [Hourly Rate Calculator](https://www.finder.com.au/business-insurance/hourly-rate-calculator).

### Unit price

For product-based businesses, determining a unit price is critical to ensuring each product is profitable.

### Calculation steps for unit prices

There are 5 key steps to help calculate the price of your units or products.

Table 9: Unit price calculation

|  |  |  |
| --- | --- | --- |
| Step | Description | Example |
| 1. Total production costs | Calculate all costs associated with producing the candles, including direct costs (materials, labour) and indirect costs (overheads). | For EcoGlow Pty Ltd, assume the total direct material costs are $200. This includes the cost of wicks, fragrance oils and packaging. The total direct labour costs) total $100. So, the business’s total direct cost is $200 + $100 = $300.  EcoGlow Pty Ltd also has some overhead costs that total $100.  The total production costs = $300 + $100 = $400. |
| 1. Number of units produced | Determine the total number of products produced in a specific period (such as monthly). | If you produced 200 candles in a month, then the number of units produced = 200. |
| 1. Cost per unit | Calculate the cost incurred for each candle by dividing total production costs by the number of units produced. | Cost per unit = $400 ÷ 200  = $2 per candle. |
| 1. Desired profit margin | Establish the profit margin you want to achieve on each candle sold (for example, 40%). | If you want a profit margin of 40%, this means you want to earn $0.80 on each candle ($2 × $0.40). |
| 1. Selling price per unit | Calculate the final selling price by adding the desired profit margin to the cost per unit. | Selling price = $2 + $0.80 = $2.80 per candle. |

This approach can help you determine the price of the items you are selling to make a profit. Note that these pricing calculations do not account for competitors in the market and should be considered carefully to be sustainable. If you need to check that your unit and labour prices are meeting your expenses, you can conduct a break-even analysis.

 Practice activity

### Activity 2: Unit price for Gourmet Coffee Pty Ltd

Review the scenario, then answer the questions. You can use the tab **Activity 2** in [Cl\_Finance\_TL\_Appx\_FnclTmplts (xlsx)](https://share.tafensw.edu.au/share/items/b7ae392b-2e9f-4db3-89a9-0caa32fd7b2e/0/?attachment.uuid=a793926c-2303-41d1-9273-7c7b2f2d4bad) to help with your calculations.

**Activity scenario:** Gourmet Coffee Pty Ltd is a new coffee shop that has recently launched a premium latte drink in its store. However, the owners are unsure of how much the selling price for each unit of coffee should be to reach its desired profit margin. They have, however, worked out some of the details.

Table 10: Unit price template table

|  |  |
| --- | --- |
| Items | Amount |
| Total production costs per month  (Includes ingredient and labour costs as well as overheads) | $15,000 |
| Number of units produced per month  (Based on past months sales, averaging around 100 cups sold a day) | 3,000 cups |
| Cost per unit | Blank cell |
| Desired profit margin mark-up rate | 30% |
| Desired profit margin | Blank cell |
| Selling price per unit | Blank cell |

1. Calculate the cost per unit for each coffee.
2. Calculate the selling price per unit for each coffee. Round your answer to 1 decimal place.

## Perform a break-even analysis

A break-even analysis determines the point at which revenues equal costs – essentially, it is the point where you can pay back what you’ve spent in operating the business.

The break-even point (BEP) can be expressed in 2 ways: **units** and **sales dollars**. Units are used to determine how many units or services to sell to break-even, while sales dollars, on the other hand, determine how much sales need to be generated to break-even.

### Calculating a breakeven point in units

You can calculate the break-even point (BEP) for units with the formula:

* **Fixed costs** – are costs that do not change with the level of production or sales. These typically include costs such as rent, salaries and insurance.
* **Sales price per unit** – is the price at which each unit of product or service is sold.
* **Variable costs per unit** – vary directly with the level of production, such as materials and direct labour.

**Scenario example:** EcoGlow Pty Ltd is producing a new line of eco-friendly candles made from soy wax and natural fragrances.

**Cost structure**

**1. Determine the fixed costs.** These are costs that do not change with the production level. For EcoGlow Pty Ltd, fixed costs include:

Rent: $1,000 per month

Utilities (mixed): $200 per month

Salaries (owner and part-time help): $2,000 per month

Marketing and advertising: $300 per month

Total fixed costs = $1,000 + $200 + $2,000 + $300 = $3,500

**2. Determine variable cost of goods.** These are production costs that vary directly with the production volume. For EcoGlow Pty Ltd, the variable cost per candle includes:

Soy wax: $2.00

Wick: $0.50

Fragrance oil: $1.00

Packaging: $0.75

Total cost of goods per candle = $2.00 + $0.50 + $1.00 + $0.75 = $4.25

**3. Determine the selling price.** Determine the selling price at which each unit of product is currently sold to customers. Selling price per candle: EcoGlow Pty Ltd sells each candle for $12.00.

**4. Calculate the break-even point.** Use the formula to find out how many units need to be sold to cover all costs.

Break-even point in units’ formula = (Total fixed costs) ÷ (Selling price per unit – cost of goods per unit)

Break-even point in units = $3,500 ÷ ($12 – $4.25)

= $3,500 ÷ $7.75 = $451.61

EcoGlow Pty Ltd needs to sell approximately 452 candles per month to break-even.

### Calculating a breakeven point in sales dollars

The break-even point (BEP) for sales dollars can be calculated using the following formula:

The contribution margin measures a product or service's profitability by indicating how much revenue remains after covering variable costs. You calculate the contribution margin using the given formula:

The contribution margin ratio expresses the contribution margin as a percentage of total sales revenue. It indicates what portion of each sales dollar can cover fixed costs and contribute to profit. The contribution margin ratio can be calculated using the following formula:

Using the same cost structure from EcoGlow Pty Ltd previously mentioned, the business can also determine how much it needs to make in sales dollars to break-even.

**Cost structure**

**1. Determine the fixed costs.**

These are costs that do not change with the production level. For EcoGlow Pty Ltd, the fixed costs include:

Rent: $1,000 per month

Utilities: $200 per month

Salaries (owner and part-time help): $2,000 per month

Marketing and advertising: $300 per month

Total fixed costs = $1,000 + $200 + $2,000 + $300 = $3,500

**2. Determine variable cost of goods.**

These are production costs that vary directly with the production volume. For EcoGlow Pty Ltd, variable costs per candle include:

Soy wax: $2.00

Wick: $0.50

Fragrance oil: $1.00

Packaging: $0.75

Total cost of goods (per candle) = $2.00 + $0.50 + $1.00 + $0.75 = $4.25

**3. Determine the selling price.**

Determine the selling price at which each unit of product is currently sold to customers. Selling price per candle: EcoGlow Pty Ltd sells each candle for $12.00.

**4. Calculate the gross profit margin.**

To get the gross margin per unit, you subtract the variable costs from the selling price to determine how much each unit contributes to covering the fixed cost.

Using the gross profit margin formula: Selling price – Cost of goods

**EcoGlow Pty Ltd gross profit margin**: $12 – $4.25 =$7.75

Then, calculate the gross profit margin ratio. This percentage indicates what portion of each sales dollar can cover fixed costs and contribute to profit. You can multiply your answer by 100 to express the gross profit margin as a percentage.

Gross profit margin ratio = (Selling price – Cost of goods) ÷ (Selling price)

= $7.75 ÷ $12

= 0.6458 (or 0.6458 x 100 = 64.58%)

**5. Calculate the break-even point.**

Use the formula to find out how much sales earnings is needed to cover all costs.

Break-even point (sales dollars) formula= Total fixed costs ÷ Gross profit margin

Break-even point (sales dollars) = $3,500 ÷ 0.6458 = $5,419.63

EcoGlow Pty Ltd needs to generate approximately $5,420 in sales to break-even. Remember to always round your amount upwards when you calculate your break-even point, whether you are calculating in units or sales dollars.

 Practice activity

### Activity 3: Break-even analysis for Gourmet Coffee Pty Ltd

Review the scenario, then answer the questions. You can use the tab **Activity 3** of the document [Cl\_Finance\_TL\_Appx\_FnclTmplts (xlsx)](https://share.tafensw.edu.au/share/items/b7ae392b-2e9f-4db3-89a9-0caa32fd7b2e/0/?attachment.uuid=a793926c-2303-41d1-9273-7c7b2f2d4bad) to help with your calculations.

**Activity scenario:** Gourmet Coffee Pty Ltd has been selling its premium latte for a while after its launch. The business is considering keeping coffee as a permanent menu item but its sales fluctuate monthly. As such, the business wants to work out how many cups it needs to sell per month to break-even. Gourmet Coffee Pty Ltd has worked out some of its costs in the following table.

Table 11: Gourmet Coffee Pty Ltd

|  |  |
| --- | --- |
| Item | Amount |
| Fixed costs | Blank cell |
| Utility expenses | $1,000 |
| Salaries | $8,000 |
| Rent expense | $5,000 |
| Total fixed costs | Blank cell |
| Variable costs (Cost of goods) for one coffee | Blank cell |
| Ingredients | $3 |
| Packaging | $0.50 |
| Total variable costs | Blank cell |
| Selling price | $6.50 |
| Break-even point in units | Blank cell |

1. Calculate the total fixed costs per month.

$14,000

1. Calculate the total variable costs per month. (per unit?)

$3.50 ($3 profit for $6.5 sales price)

1. Calculate the break-even point in units that Gourmet Coffee needs to achieve per month. Round up your answer to the nearest whole number.

14,000 divided by 3 = 4,667

## Choose a suitable pricing strategy

How a business prices a product or service is dependent on its goals, budget, resources and target market. For example, if a business goal is to maximise profit, the business may choose pricing opportunities to maximise the profit on each product or service sold. Suppose a business goal is to maximise the quantity of sales. In that case, it may pursue a pricing strategy that monitors competitive prices set by competitors in the same or similar industry.

By balancing these factors appropriately, your business's pricing decisions will return positive financial outcomes that support its overall growth. This will also support other business areas such as operations, marketing and customer service.

### Pricing strategy

Pricing is the process of setting the price of your product or service. It can be challenging to determine the right price. If you set your prices too high, your customers may find your products too expensive. However, if you set your prices too low, you may affect your profits.

There are 4 key categories of pricing strategies:

* cost-based
* competition-based
* perceived value
* product-related.

These strategies are foundational approaches that businesses use to price products or services. They focus on setting prices based on costs, perceived value and market positioning. Often a business will use a combination of these strategies to set their pricing. Each is reviewed separately.

#### Cost-based pricing strategies

Cost-based pricing is a strategy that involves setting prices primarily based on production and distribution costs. Examples include:

* **Cost-plus pricing** – Cost-plus pricing involves adding a desired markup to the total cost of producing a product or service. This method is straightforward but requires accurate calculations, including fixed costs.
* **Charge-per-hour** – Common in service-based businesses, this strategy calculates costs based on an hourly rate, factoring in all relevant business expenses.

Many manufacturing companies, such as Fletcher Building and Hanson Australia, use cost-plus pricing, where heaving building materials are priced based on the cost of raw materials and cost of production before adding a markup. Manufacturers prefer cost-based pricing because it is straightforward in ensuring the business can cover its costs and maintain a good profit margin. Its products usually do not require a lot of promotion or competition. Medical technology and medicine manufacturers also employ cost-based pricing strategies.

In a more competitive environment, businesses may explore competition-based, value-based and product-related strategies as added alternatives.

#### Competition-based pricing strategies

These strategies focus on setting prices concerning competitors. Examples include:

* **Going-rate pricing** – Prices are set close to the market price leader, allowing businesses to remain competitive without significantly affecting profit margins. This strategy is beneficial for small businesses in competitive markets.
* **Price-matching** – Customers can request a price adjustment if they find a lower price for the same product at a competitor’s store.

Woolworths and Coles are 2 examples of supermarket businesses that use going-rate pricing. They regularly adjust prices based on similar products and prices according to other stores, ensuring they can attract price-sensitive customers.

Similarly, many local trades businesses, such as plumbers and electricians, set hourly rates based on competitors' charges for similar services. This allows businesses to remain competitive, cover their costs and monitor their competitors for cost reduction strategies.

#### Value-based pricing strategies

These strategies set prices based on perceived value rather than just costs. Examples include:

* **Value pricing** – Prices are determined by what customers believe a product or service is worth, often established through market testing. If customers perceive significant value, this strategy can lead to higher profits.
* **Premium pricing** – Higher prices are set for products that convey prestige or luxury, reflecting customers' high expectations regarding quality and service.

Value-based pricing strategies often require more promotional effort and brand-building to generate hype. For instance, Apple sets its smartphone prices much higher than its competitors to appeal to its perceived brand value as cutting-edge, quality and aesthetic-led technology. Premium pricing, likewise, is mostly used by luxury brands to create a perception of exclusivity and high quality in their products and services.

#### Product-related pricing strategies

These strategies are tailored for new product launches and market positioning. Examples include:

* **Penetration pricing** – The business sets a low initial price to attract customers and gain market share quickly, with plans to increase prices later.
* **Skimming pricing** – The business sets a high initial price to maximise profits from early adopters before gradually lowering it to appeal to a broader market.
* **Loss-leader pricing** – In loss-leader pricing, products are offered at a competitively cheap price to attract customers. The business offsets this low price by attracting customers to purchase other products with higher-margin items (Australian Government, 2024).

Apple also uses price skimming for its smartphones, where early adopters usually purchase new products at higher prices. As the product becomes older, the price gradually drops as newer editions of the product are offered. Price drops usually need to be slow, as quick price drops can lead to early adopters feeling cheated and later customers may fall into the habit of waiting for price reductions.

On the other hand, Chemist Warehouse is an example of a business that uses loss-leader pricing as many of its products are discounted or cheaper than other retail competitors. To offset the lower profit margin (or loss of profit in some cases), these discounts can encourage customers to purchase more products or purchase higher-margin items (such as vitamins and supplements).

Your pricing strategy will depend on your business goals and objectives and existing competitors in the market. The 4 pricing strategies are not mutually exclusive; you can combine them or consider all factors in developing the right strategy for your business.

**Scenario example**:

Suppose you run a skincare line and decide to change your pricing strategy. After calculating that each product costs $10 to produce, you notice competitors sell similar products for $15 to $25. You aim to capture more market share to make your business more well-known, so you choose a penetration pricing strategy – you set your initial price at $12.

You launch the new price and monitor sales closely and 12 is an attractive price for cost-conscious customers; however, it may give you a lower profit margin. If sales increase significantly, you may consider gradually raising the price once you've established a loyal customer base.

These steps can help you through the process of pricing your products:

* calculate your costs
* determine your pricing objectives
* assess your pricing strategy
* competition-based pricing strategies
* legislation and regulations
* discounts
* research
* testing of different pricing approaches.

 Resources

For more information about creating pricing strategies relevant to your business planning, you can refer to the Australian government’s resource on how to [Develop a pricing strategy](https://business.gov.au/products-and-services/develop-a-pricing-strategy).

If you are in the early stages of your business and you are not sure on the pricing strategy to use, you can use AI tools such as [Microsoft Copilot](https://copilot.microsoft.com/). An example of this is provided in the example.

**Prompt:**

I intend to start a small business selling flowers, what is the most popular pricing strategy for my business and why?

**Response:**

For florist shops, Cost-plus pricing is one of the most popular and widely used strategies. Is this an error This method involves calculating the total cost of producing a floral arrangement (including flowers, vases, labour and overhead) and then adding a markup to ensure profit. It's straightforward and ensures all costs are covered, making it a reliable choice for many florists.

 Practice activity

### Activity 4: Setting a pricing strategy

Using your own business idea or [Azure Beach Surf and Skate](https://share.tafensw.edu.au/share/items/1c89b5bb-2698-4ced-91d8-29a58efbaab2/0/?attachment.uuid=74f8070a-c4c0-4c14-a007-aedc47689889), you will utilise [Microsoft Copilot](https://copilot.microsoft.com/) to determine a pricing strategy for your products.

1. What was the suggested pricing strategy for your business and why? Your answer should be between 50 and 100 words.

## Prepare a financial plan

Creating a comprehensive financial plan is essential for achieving your long-term goals, providing a clear roadmap to navigate your financial future with confidence and purpose.

### What is a financial plan?

A financial plan is a plan that details the business's current financial position and ensures its financial objectives align with overall business goals. Specifically, it provides a clear financial picture and outlines the steps required to facilitate strategic decision-making, manage risks, monitor financial health and attract investments.

As such, a financial plan usually contains 3 main aspects:

1. Details about the business’s current financial health and standing and its current strategies, profit targets and overall business goals. If your business is newly established, your plan should also include any startup costs that the business needs to recover or fund.

Your start-up costs are costs you incur before your business gains income. This can include expenses such as solicitor’s fees, licenses and business registration fees. If you operate in a physical space, it also includes set up costs for machinery, fixtures and setting up utilities such as plumbing and electricity.

1. Outlines about the business’s financial performance and projections by providing 3 main financial statements – profit and loss statement, balance sheet and cash flow statements and any budgets and future cash flow forecasts that explain how the business can responsibly use its finances. You should also include a break-even analysis to indicate your product or service is more likely to be profitable.
2. Plans to continue monitoring the business’s financial health as it grows and matures. This also includes contingency plans that can anticipate any turbulent periods the business may face for future planning.

Developing a financial plan keeps you prepared for the financial challenges your business could face and allows you to pivot and diversify your financial strategies. It also makes your business more attractive to potential investors.

## Identify working capital needs

Working capital is the difference between a business’s current assets and current liabilities. Businesses strategically identify and assess their working capital requirements if they want to meet their profit projections.

Identifying a business’s working capital requirements involves understanding the essential resources needed for day-to-day operations, such as inventory management, accounts receivable and payable cycles, which all play a crucial role in maintaining liquidity and operational efficiency.

Liquidity refers to a business's efficiency in converting its assets into cash to meet its short-term and day-to-day obligations. When a business is liquid, it has enough cash to pay off any short-term debts that may arise.

A business is also more liquid when it has more current assets than current liabilities.

### Manage business capital

Maintaining and preserving capital will require you to continually meet the requirements of your financial backers. There may be stipulations in place within your agreements. Therefore, you should:

* analyse your organisation's strengths and weaknesses and take action based on them
* regularly review your financial plans and strategies as the market changes
* to not be afraid of opportunities but be aware of running out of capital
* monitor your ability to access liquidity and cash
* consult with key stakeholders to get their opinions of your business
* create cash flow plans to prevent sudden cash shortages
* manage your debt, which may include exploring options for re-negotiation and reviewing at other forms of liquidity
* control and cut costs, particularly in unstable economic environments. However, be careful not to erode capital or undermine your business strategy.

Optimising capital when implementing the business plan may include:

* giving special consideration to all decisions regarding capital; do not use it wastefully
* developing operational efficiency strategies
* identifying areas of poor asset management and capital deployment
* using benchmarks to monitor your asset performance, both internally and externally (against competitors)
* implementing plans in place so you can get more capital quickly if you need it.

### Understand capital Investment

Capital investment is different from general everyday expenses, such as wages, stationery, electricity and other overheads. Understanding the differences is important so you can correctly allocate the expenses made between general purchases and capital purchases on your Business Activity Statement (BAS) report.

Capital investment concerns the deployment of capital for long-term uses and refers to the essential investments by which your business provides the product or service to the customer. Capital investment is a good measure of the health of your business, its finances and the economy in general.

#### Reasons for capital investment

The reasons for capital investments include:

* purchasing additional capital assets to allow the business to expand
* capitalising on advancements in technology to increase the efficiency of the business, thereby reducing costs
* replacing existing assets that have reached the end of their utility, such as a high-mileage delivery van.

When identifying your business's capital investment requirements, you will have to consider every need and cost involved in each process so you can make an accurate calculation.

Capital investment requirements may include:

* improving working conditions within a business to ensure their long-term safety
* changing, repairing or replacing equipment or machinery to reduce errors and maintain consistent output
* improving employee skills or upgrading machinery to develop product quality
* investing in packaging, shipping and infrastructure to meet customer needs and demands
* buying land and real estate for work sites rather than leasing.

Each of these capital investment requirements may occur during different operational periods within the business. For instance, buying land or real estate might be a particular priority for you and capital investment for it would come near the beginning of your business. Other investments might be more ongoing, for instance, in the development of packaging, shipping and infrastructure.

On the other hand, you should not need to invest in upgrades or replacements for your equipment or machinery for a considerable amount of time. Therefore, you need to work out not only how much capital investment you will need but also when you will need it.

#### Budgets for capital investments

When planning your budgets, it is essential to schedule the expense cost of any capital investments and allocate these costs to the correct operational period. This will help you to correctly forecast your cash flow more accurately.

## Prepare a profit and loss statement

A profit and loss statement (P&L) or income statement is a financial report summarising the revenues, costs and expenses incurred during a specific period – typically monthly, quarterly or annually. By comparing total revenue against total expenses, it provides insights into a business's ability to generate net profit.

The P&L statement is essential for understanding financial performance and is often used by business owners, investors and creditors to evaluate a business's viability and profitability. It also plays a crucial role in cash flow projections by providing vital information about a business's revenues and expenses over a specific period.

### Key parts of a profit and loss statement

A profit and loss statement records all the past total revenue and expenses in a specified reporting period. Your total revenue and expenses are summarised across various sources, such as invoices, receipts and bank transactions specific to your chosen reporting period. The following table shows additional key components that a profit and loss statement will have.

Table 12: Profit and loss statement components

|  |  |  |
| --- | --- | --- |
| Component | Description | Example |
| Revenue | Revenue is the total income generated from sales of goods or services before any expenses are deducted. | Total revenue = Sales revenue + Other income (can include rental income or investments). |
| Cost of goods sold (COGS) | Direct costs associated with producing the goods sold, including raw materials, packaging and production expenses. | COGS = Raw materials + Direct labour + Production overhead. |
| Gross profit | Calculated as revenue minus COGS; indicates how efficiently a business uses its resources to produce goods. | Net profit before tax = Gross profit − Total operating expenses. |
| Operating expenses | The costs incurred by a business in the process of generating revenue, including salaries, rent and utilities. | Total operating expenses = Sum of all operating expenses such as salaries, rent and utilities. |
| Net profit before tax | Calculated by subtracting total operating expenses from gross profit; shows profit earned before accounting for taxes. | Net profit before tax = Gross profit − Total operating expenses. |
| Income tax expense | The amount of tax owed based on net profit before tax. | Income tax expense = Net profit before tax x Tax rate. |
| Net profit after tax | The final profit figure after all expenses and taxes have been deducted; represents the actual profit available to the business. | Net profit after tax = Net profit before tax − Income tax expense. |

**Scenario example:**

EcoGlow Pty Ltd generated a total sales revenue of $150,000 from candle sales during the reporting period.

COGS includes all direct costs associated with producing the candles:

Raw materials: $15,000 (includes soy wax, beeswax, essential oils and wicks)

Packaging: $5,000 (eco-friendly containers and labels)

Production: $10,000 (equipment maintenance and production staff)

**The operating expenses for EcoGlow Pty Ltd were identified as:**

Marketing and advertising: $20,000

Product development: $15,000

Operational costs: $10,000

Salaries and wages: $40,000

Delivery costs: $10,000

Rent and utilities: $5,000

Stationery and printing costs: $5,000

Once you have the figures for each key component, you can assemble your P&L statement. Accounting software such as Xero automates the process.

Review the sample format of EcoGlow Pty Ltd’s P&L statement for the 30th of June 20XX in the table. All figures are GST-exclusive.

Please note that some financial statements use brackets, for example, **($000)**, to indicate negative figures. The formulas in the financial statement are used for educational purposes only.

Table 13: EcoGlow Pty Ltd profit and loss statement with all figures excluding GST

|  |  |
| --- | --- |
| Item | ($) |
| **Revenue** | Blank cell |
| Sales revenue | 150,000 |
| Total cost of goods sold (COGS)  (Raw materials + packaging + production) | (30,000) |
| Gross profit | 120,000 |
| **Operating expenses** | Blank cell |
| Marketing and advertising | (20,000) |
| Product development | (15,000) |
| Repairs and maintenance | (10,000) |
| Salaries and wages | (40,000) |
| Delivery costs | (10,000) |
| Rent and utilities | (5,000) |
| Stationery and printing | (5,000) |
| **Total operating expenses** | (105,000) |
| **Net profit before tax** | 15,000 |
| **Income tax expense (25%)** | 3,750 |
| **Net profit after tax (NPBT – income tax expense)** | 11,250 |

### Financial statements and Goods and Service Tax

In Australia, Goods and Service Tax (GST) is a tax on most goods and services sold in Australia. If your business is registered for GST, you collect the tax from your customers (generally one-eleventh of the sales price) and pay it to the Australian Taxation Office (ATO) when it is due (Australian Government, 2024). It is important to note that businesses do not pay for GST.

GST is subject to specific accounting standards and regulations. Generally, profit and loss statements recognise revenue and expenses net of GST for all categories where GST is charged by the business. This is because businesses collect GST on behalf of the Government and can claim input tax credits for GST paid on purchases, so GST is not considered to affect profit calculations.

If a business opts to include GST in its profit and loss statement, it must clearly disclose whether the figures are GST-inclusive or GST-exclusive. Usually, businesses that do include GST in profit and losses are those not registered for GST or do not earn enough annual income to meet the GST registration threshold of $75,000.

Businesses registered for GST, however, must report GST collected on sales and GST paid on purchases through their BAS. You will learn more about GST reporting requirements under the tax requirements subtopic.

 Practice activity

### Activity 5: Gourmet Coffee Pty Ltd’s profit and loss statement

Review a simplified profit and loss statement for another business, Gourmet Coffee Co Pty Ltd for 30th June 20XX using the tab **Activity 5** [Cl\_Finance\_TL\_Appx\_FnclTmplts (xlsx)](https://share.tafensw.edu.au/share/items/b7ae392b-2e9f-4db3-89a9-0caa32fd7b2e/0/?attachment.uuid=a793926c-2303-41d1-9273-7c7b2f2d4bad). Then, review the questions and select the correct answers.

**Activity scenario:** Gourmet Coffee is a small coffee business that specialises in selling coffee products. They have a coffee shop where they sell coffee and food to consumers but also supply barista products to other local businesses. Here is the profit and loss statement as of 30th June 20XX. All figures in the statement exclude GST.

Table 14: Gourmet Coffee Co P&L statement

|  |  |
| --- | --- |
| Item | ($) |
| **Revenue** | Blank cell |
| Sales revenue | 95,000 |
| Less cost of goods sold (COGS) | (10,000) |
| Gross profit | 85,000 |
| **Operating expenses** | Blank cell |
| Wages | (20,000) |
| Utilities | (16,000) |
| Rent | (40,000) |
| Coffee machine maintenance | (6000) |
| Depreciation expense | (500) |
| **Total operating expenses** | (82,500) |
| **Net profit before tax** | 2,500 |
| **Income tax expense (25%)** | 625 |
| **Net profit after tax (NPBT – income tax expense)** | Blank cell |

1. What is the net profit after tax for the financial period?

Table 15: Multiple choice

|  |  |  |
| --- | --- | --- |
| # | Choices | Answer |
|  | A profit gain of $12,500 |  |
|  | A profit gain of $1,875 |  |
|  | A profit loss of $12,500 |  |
|  | A profit loss of $1,875 |  |

1. What is a possible reason that Gourmet Coffee Co. has a much lower net profit after tax (NPAT) compared to gross profit?

Table 16: Multiple choice

|  |  |  |
| --- | --- | --- |
| # | Choices | Answer |
|  | Gourmet Coffee Co was taxed too much which pushed net profit down. |  |
|  | Gourmet Coffee Co generated too little sales and too little gross profit. |  |
|  | The cost of rent contributed to an excess of expenses that the gross profit needed to cover, which lowered its net profit. |  |
|  | Gourmet Coffee Co spends too much on maintaining its machinery and cost of goods sold, which lowered both its gross profit and net profit. |  |

## Prepare a projected profit statement

A projected profit and loss statement uses past profit and loss statements to estimate future revenue, income and expenses over a specific reporting period. Projected profit statements can forecast financial figures monthly, quarterly or yearly, though for newly established businesses, it is beneficial to plan for the next 12 months. A projected P&L statement is not an official document that must comply with all accounting standards; however, it is helpful for investors to understand a business's profitability, strategic planning and how well it can handle recurring expenses over a future period.

### How to create a projected profit statement

There are 4 steps to project profit and loss statements.

1. Have a baseline profit and loss statement.
2. Decide on the forecasting period.
3. Determine assumptions that you will use in your forecast.
4. Review and prepare your projected profit statement.

#### Step 1: Have a baseline profit and loss statement

Use your most recent income statement and any relevant financial data from previous years to establish a baseline profit and loss statement for your projections. Businesses usually use their P&L statements from the current or last financial year. However, newer businesses may use the P&L statement from the previous month.

#### Step 2: Decide on the forecasting period

Determine how far into the future you want to project your profit and loss statement. This period could be monthly, quarterly or annually. For new businesses, it is ideal to forecast profit and loss across the next 12 months.

#### Step 3: Determine assumptions that you will use in your forecast

Identify all assumptions that affect your business’s sales and expenses for the forecasting period. These assumptions can include any changes in operational expenses, loan terms, market conditions and significant business decisions such as new product launches or marketing campaigns.

Often assumptions are sourced from historical data or documentation to make projections as grounded as possible. For example, a business could expect to receive income from a grant in the coming months due to the grantor sending them a letter of approval. They may pay a fixed and consistent amount of rent across 12 months due to their lease agreement. They may base their future operating expenses on past bills and quotes.

#### Step 4: Review and prepare your projected profit statement

Review your assumptions and create a pro forma income statement that reflects projected revenues, expenses and net income based on your assumptions. Each monthly projection should be under a different column to show the business’s performance over the forecasting period.

 Practice activity

### Activity 6: Projected profit and loss statement for EcoGlow Pty Ltd

**Activity scenario:** To prepare for the 2026 financial year, EcoGlow Pty Ltd has created a projected P&L statement across the 12-month period. The first month, June 2025, is used as a baseline for the next 12 months of forecasting. The projected P&L statement assumes all figures exclude GST.

Review the projected profit and loss statement for EcoGlow Pty Ltd over the 12-month period using the tab **Activity 6** [Cl\_Finance\_TL\_Appx\_FnclTmplts (xlsx)](https://share.tafensw.edu.au/share/items/b7ae392b-2e9f-4db3-89a9-0caa32fd7b2e/0/?attachment.uuid=a793926c-2303-41d1-9273-7c7b2f2d4bad). Then select the correct answers to the 2 questions.

1. What are 3 relevant assumptions that EcoGlow Pty Ltd made in their projections?

Table 17: Multiple choice

|  |  |  |
| --- | --- | --- |
| # | Choices | Answers |
|  | Seasonal increase in motor vehicle expenses and advertising fees to cater to holiday sale fluctuations. |  |
|  | An increase in overall income tax. |  |
|  | An increase in sales revenue for holiday sales and a decrease in sales during hotter seasonal months. |  |
|  | An increase in all income and expenses due to inflation which the business adjusts for at the start of January 2025. |  |

1. Why was there a significant drop in profit from July 2025 to October 2025?

Table 18: Multiple choice

|  |  |  |
| --- | --- | --- |
| # | Choices | Answer |
|  | The business expects an increase in operating expenses due to inflation. |  |
|  | The business expects an adjustment in inflation to increase all its expenses which will decrease its net profit overall. |  |
|  | The business expects a drop in sales demand during warmer seasonal months which would decrease its gross profit. However, expenses remain static which the business has to pay for. |  |
|  | The business expects a high increase in cost of goods sold due to increased sales demand. |  |

 Resources

For further information on how you can make a projection profit and loss statement for your own business, you can refer to the Australian government’s webpage [Set up a profit and loss statement](https://business.gov.au/finance/financial-tools-and-templates/set-up-a-profit-and-loss-statement) for a template and further planning tips.

## Understand a balance sheet

A balance sheet is one of many financial statements a business will create to show its financial information. Its purpose is to capture your business's assets, liabilities and equity on a specific date and provide a snapshot of what your business is worth overall. It also allows you to monitor your business’s financial health at different intervals. Essentially:

* A balance sheet indicates a business’s overall value over a specific period.
* A profit and loss statement indicates a business’s profitability over a specific period.

A balance sheet can be displayed either in 2 columns side by side, showing that the assets on one side equal the liabilities and owner's equity together on the other side. Another method is to have it documented in a vertical format, like a profit and loss statement, where the assets, liabilities and owner's equity are grouped together. This format is more common for businesses that need to compare financial figures across different years.

### Key parts of a balance sheet

There are 3 main components of a balance sheet – assets, liabilities and owner’s equity.

* **Assets** – These are financial resources owned by a business that have economic value with the expectation that they can be used to provide a future benefit. This includes cash, inventory and property. Assets can be bought or leased.
* **Liabilities** – These are obligations or debts that a business owes to external parties, such as loans and accounts payable.
* **Owner’s equity** – This is a portion of a company's assets that is financed by the owners' investments rather than by debt.

In balance sheets, assets and liabilities are categorised as either current or non-current.

Table 19: Key components in a balance sheet

|  |  |  |
| --- | --- | --- |
| Balance sheet component | Definition | Example |
| Current assets | Current assets refer to the amount of cash and other business assets that will turn into cash within one operating year or less than 12 months.  Current assets are important as they are indicative of how the business funds its day-to-day operations. | * Cash, including bank accounts and petty cash (this is sometimes listed as cash and cash equivalents) * Accounts receivables (funds your customers owe you) * Temporary investments (maturing within 12 months) * Prepaid expenses (for example, prepaid insurance) * Inventory * Supplies |
| Non-current assets | Non-current assets may include:   * Non-current assets, also referred to as long-term or fixed assets, are resources owned by a business that are not expected to be converted into cash within a year. | Non-current assets may include:   * property, plant and equipment * building or land (can include rental assets or assets under lease). |
| Current liabilities | Current liabilities refer to the business's debts and obligations that are due within one year. | Current liabilities include:   * accounts payable (any outstanding invoices you owe to other businesses or suppliers) * short term loans (to be paid off within 12 months) * payables to the ATO, including GST and PAYG. |
| Non-current liabilities | Non-current liabilities refer to the business's debts and obligations that are expected to be paid after a period of one year. | Non-current liabilities may include:   * long term loans * mortgages * bonds payable. |
| Owner's equity | Owner's equity refers to the owner's investment in the business less any withdrawals they have made, plus any net income (or minus if it is a net loss). | If your business is a sole trader or partnership, all owner’s equity goes to the owner or partners. |

### How to prepare a balance sheet

A balance sheet uses the accounting equation:

Assets = Liabilities + Owner's equity

Of course, this equation can be rearranged in many ways to mean the same thing. For example, Assets – Liabilities = Owner’s equity. This equation shows the relationship between assets, liabilities and the owner's equity of a person or business within the balance sheet.

Preparing a balance sheet involves following a set of rules that are like preparing a profit and loss statement.

* Specify the reporting period. A balance sheet is typically developed on the last day of a financial period, such as the last day of a quarter, half year or end of a financial year.
* Identify your assets, both current and non-current. This includes any depreciation attached to non-current assets. Then, identify your current and non-current liabilities for a specific financial period.

**What is depreciation?**

Depreciation is a decrease in asset value. When you use an asset such as a motor vehicle for your business operations, it will experience wear and tear. Recording depreciation costs will give you a more accurate snapshot of your business’s value. You’ll learn more about depreciation in Lesson 2: Non-current assets’ sub lesson.

* Separate the non-current items from the current items so it is easier to prepare your report.
* Using a pre-setup template provided by your accounting software, transfer the accounts and their balances from all assets, liabilities and owner's equity as described in Step 2.
* After transferring your data, calculate the owner’s equity. This includes money the owner has put into the business, less any drawings, plus any net profit (after tax), as indicated in the profit and loss statement. Then use the formula: **Assets = Liabilities + Owner’s equity**.
* Ensure that your balance sheet balances. The following figure shows an example of a balance sheet by EcoGlow Pty Ltd.

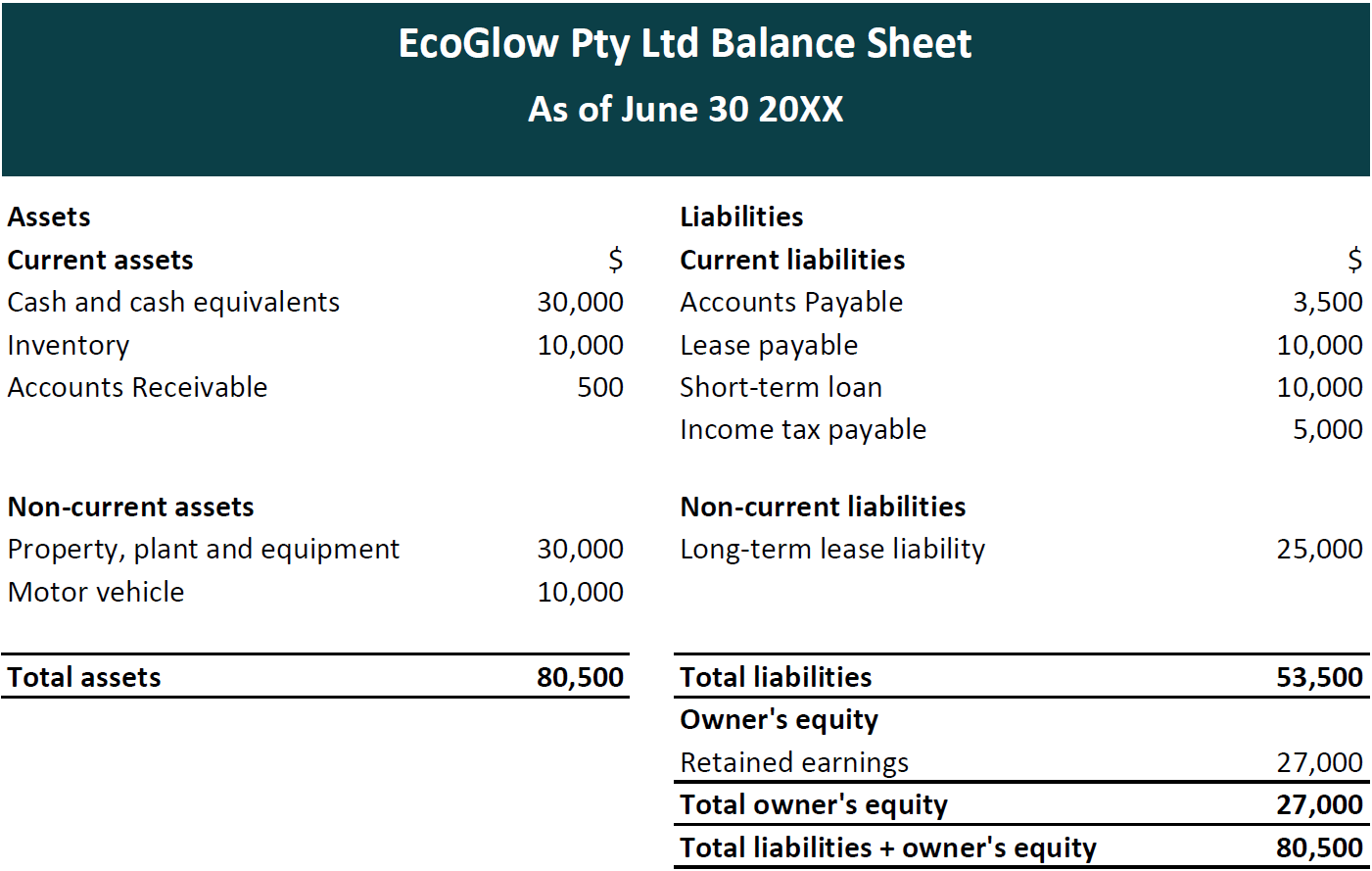


Figure 2: © TAFE NSW 2025 | [Long image description](https://share.tafensw.edu.au/share/items/b7ae392b-2e9f-4db3-89a9-0caa32fd7b2e/0/?attachment.uuid=649069a0-f6a4-4c76-ad3c-594e170be7eb)

## Prepare a cash flow statement

A cash flow statement is a financial document detailing the amount of cash that flows in and out of a business over a specified period – it can be monthly, quarterly or annually. A cash flow statement is different from a profit and loss statement in that it outlines your business’s availability of cash on hand. It also allows you to estimate how well your business can meet its obligations when they fall due daily.

**Cash is king.**

In a 2021 study conducted by CB Insights, running out of cash is the second leading cause of start-up failure CB Insights (2021). Many businesses make the mistake of assuming that high profit or sales mean the business has enough cash to cover itself in times of shortfalls or financial stress.

Cash flow is the net balance of cash flowing in and out of a business at a specific time. When cash flow is positive, the business has more money moving into it than out. When cash flow is negative, a business has more cash moving out than in.

**EcoGlow Pty Ltd cash shortfall example:**

In finance, it is essential to understand the difference between profit and cash. An increase in profit does not necessarily mean an increase in cash; an increase in cash does not mean an increase in profit.

Imagine you are an accountant hired to advise EcoGlow Pty Ltd on their cash flow management. You compare the cash and cash equivalents on the balance sheet in the current financial year, which is around $5,000, to last year’s cash and cash equivalents of $10,000. When you review this year’s profit and loss statement, the business has generated a net profit of $11,000. How can the business be struggling for cash?

A cash flow statement can help you determine the cause of the cash decline. For example, the statement may indicate that EcoGlow Pty Ltd opened a second store in a city location and needed to cash out a significant investment for the store’s set-up costs. EcoGlow Pty Ltd may also be a supplier to other businesses that have not paid their invoices on time.

It is possible for a business to gain profit yet struggle to pay its debts on time. Understanding where your cash is going and why is crucial for financial management.

### How to review a cash flow statement

The quickest way to determine your business’s liquidity in a cash flow statement is to review at the trend of the closing cash balance across a reporting period. This means reviewing at the trend of how much cash your business has at the end of each day, month, quarter or year, depending on how you or your accounting software sets up the cash flow statement.

Here are examples of how cash flows can be categorised:

Table 20: Types of cash flow in a cash flow projection

|  |  |  |
| --- | --- | --- |
| Cash flow category | Description | Example |
| Cash flow from operating activities (or operating cash flow) | Cash gained and used to run the business’s core day-to-day operations. | * cash from sales revenue * rent and utilities expenses * payment to suppliers * income tax payments * salary payments |
| Cash flow from investing activities | Cash gained and used in the acquisition and sale of long-term assets and investments. | * purchase of new personal protective equipment (PPE) * sale of PPE * proceeds from investments |
| Cash flow from financing activities | Cash gained and used relates to how your business builds capital and repays its investors. | * cash from grants * repayment of loans |
| Cash inflow | Any income or revenue your business receives. | * cash from revenue * cash from grants |
| Cash outflow | Any expenses or debt obligations your business needs to pay for. | * repayment of loans * tax provisions * overhead expenses |
| Net cash balance | The total change in cash after all cash inflows and outflows have been accounted for. | A net cash inflow indicates the total amount of cash your business gained in a period. A net cash outflow indicates your business lost cash during that period. |

Review the cash flow statement from EcoGlow Pty Ltd for a more detailed example:

Table 21: Cash flow statement for EcoGlow Pty Ltd

|  |  |
| --- | --- |
| Cash flow statement for EcoGlow Pty Ltd as of 30 June 20XX | Amount ($) |
| **Opening cash balance** | 120,000 |
| **Cash flows from operating activities** | Blank cell |
| Cash from sales | 100,000 |
| **Income tax paid** | (13,000) |
| **Material purchases** | (25,000) |
| **Overhead expenses** | (45,000) |
| Cash paid for advertising fee | (12,000) |
| **Cash flows from investing activities** | Blank cell |
| Purchase of new candle-making equipment | (10,000) |
| Sale of motor vehicle | 12,000 |
| **Cash flow from financing activities** | Blank cell |
| Government grant | 10,000 |
| **Closing cash balance** | 137,000 |
| **Net cash inflow or outflow** | 17,000 |

EcoGlow Pty Ltd’s cash flow statement for the end of the financial year 20XX shows an opening cash balance of $120,000, which means the business had $120,000 at the start of that reporting period.

The closing cash balance was $137,000, which means they had more cash at the end of the year than they started with. This is due to the business receiving a net cash inflow of $17,000. The opening cash balance at the start of the next reporting period will also be $137,000.

Negative cash flow can be an accumulative issue for small businesses, as it indicates that they cannot cover their operating expenses and debt obligations. This can further repel external investors from supporting the business and existing lenders may prematurely recall their loans, which results in further cash flow management problems.

However, a low cash flow does not mean the business is destined to fail – a business may have a sudden cash shortfall due to new investments in property or equipment. Conversely, if there is a declining or negative cash flow trend over a reporting period, the general rule of thumb is that your business is in poor financial health.

## Budget financial requirements

In financial planning, budgets are statements that forecast a business's expected income, expenditures and cash flow over a specified period. Budgets are essential to both the business and its external (or potential) investors because they demonstrate the owner's decision-making skills and ability to allocate resources appropriately.

A completed budget should include:

* profit and loss income statement with key information about revenue and expenses
* cash flow projection with key information about cash expenditures
* budget assumptions based on historical data, business goals and future contractual obligations
* mentions of any tax and legal costs.

A budget needs to estimate expenditure levels based on data from previous years while also considering specific factors that will impact expenses, such as new products, larger shop space or a downturn in the market. To effectively select budget targets and enable ongoing monitoring of financial performance, businesses should follow a structured approach that encompasses several key steps, including:

* reviewing past performance
* reviewing your tax and legal obligations
* setting clear financial goals
* developing flexible budgets and clear financial projections
* leveraging technology.

It is vital to have a conservative and realistic outlook when producing a budget. This means using data based on the most likely outcome. While this does not rule out good outcomes, it prepares the business for bad outcomes. If the budget is too optimistic, the business will appear as if it has performed poorly, even if that is false. The owner will then be forced to explain this.

On the other hand, a budget that is too easy to achieve can prevent organisational growth. Employees will not have to work hard to reach their targets, which may affect their motivation to take initiative.

It is helpful to get feedback on budgets from employees. They are knowledgeable about expenses and revenue relevant to their job expertise. You should also consider any other input, such as relevant trade news or business developments that can affect your profits and expenses. As the competitive landscape is ever-changing, your budget should also periodically change to keep up with any new financial requirements.

## Understand legal and tax requirements

A business must adhere to the laws and regulations of its operating jurisdiction. Government authorities often set legal requirements at local, state and federal levels and these laws encompass many areas critical to business operations. All new start-ups will have financial obligations due to specific legal and tax requirements relevant to their legal structure, income and jurisdiction.

### Business registration and start-up costs

All businesses in Australia must register with the appropriate authorities to operate legally. This includes obtaining an Australian Business Number (ABN), a unique identifier for tax purposes. Depending on the nature of the business, additional registrations, such as Goods and Services Tax (GST) registration, may be required if the annual turnover exceeds $75,000. You should ensure that all registrations are updated to avoid penalties and maintain compliance with regulatory requirements. These registration requirements may include:

* an Australian Business Number (ABN)
* an Australian Company Number (ACN) if the business is a company.

Other registrations, such as registering a domain name or trademark, may apply to the business. If your business operates as a small company, a different registration process applies than if the business were a sole trader, partnership or trust.

### Tax requirements

As a business owner in Australia, you have certain financial requirements and legal obligations you must abide by, including the provision of tax and superannuation.

The 2 main tax obligations are:

* **Income tax** – **A** tax levied on the assessable income earned by businesses, including companies, sole traders, partnerships and trusts. The amount of tax a business pays is dependent on its legal structure.
* **Goods and services tax (GST)** – A tax on most goods and services sold in Australia that businesses collect from customers. If your business meets a certain threshold of annual GST turnover or provides a taxi or ride-sourcing service, you must register for GST. When your business is registered for GST, you may need to lodge a business activity statement (BAS). This statement reports your GST, pay-you-go (PAYG) instalments, PAYG withholding taxes and other tax obligations to the Australian Taxation Office (ATO).
* **Pay as you go withholding (PAYG)** – A portion of your employee’s wages and salaries that you, as an employer, withhold to send to the ATO on their behalf.

Superannuation is another compulsory cost you may need to account for. It is a contribution employers pay to employees that varies according to their work hours and earnings. These costs can affect both your financial statements and your budget.

### Tax planning strategies

Planning your tax requirements before the financial year can help your business meet its tax and other contribution obligations on time. Small businesses can use several strategies to ensure they prepare their tax provisions on time to meet tax obligations. This includes:

* using Xero as an accounting system to streamline your BAS lodgement and other payroll obligations
* setting up a tax calendar including all tax-related due dates for BAS lodgements, payroll management and tax payments
* creating a budget or cash flow projection in your financial plan to specifically account for tax provisions
* engaging with a tax accountant or advisor who can assist your business with tax planning and compliance.

Failing to pay tax obligations on time in Australia can result in the ATO issuing significant penalties, interest charges and other legal outcomes. Ensuring your business does not fall through tax obligations is vital to financial management and its success.

 Resources

Visit the website [Business structures – key tax obligations](https://www.ato.gov.au/businesses-and-organisations/starting-registering-or-closing-a-business/starting-your-own-business/business-structures-key-tax-obligations) for further information from the Australian Tax Office (ATO) about each business structure and their associated tax obligations. This will support your business’s ability to be completely tax compliant.

You can review the ATO’s [Tax basics for small business video series](https://www.ato.gov.au/businesses-and-organisations/starting-registering-or-closing-a-business/starting-your-own-business/tax-basics-for-small-business-video-series) to access a series of short videos that cover the basic tax obligations that small businesses should understand. This will ensure your business is tax-compliant.

You can also review how to lodge your BAS online through Xero by reviewing the webpage [Lodge activity statements with Xero](https://central.xero.com/s/article/Lodge-activity-statements-with-Xero). This informative site will help you to understand all the steps you need to take when lodging your BAS through Xero.

## Prepare cash flow projections

A cash flow projection forecasts the amount of cash flowing into and out of a business over a specific period. It is similar to a cash flow statement; however, the purpose is different – cash flow projections predict how your business will perform in the foreseeable future.

Forecasting is crucial for maintaining liquidity, planning for growth and ensuring the business meets its financial obligations. Effective cash flow management helps businesses make informed strategic decisions and minimise the risk of running out of cash.

Cash flow forecasting typically relies on historical data and assumptions to make accurate future predictions. This includes finding documentation such as invoices, receipts, grant approval documentation and contracts to confirm your estimations and using a cash flow statement from your last reporting period.

However, estimates can also be provided for new businesses without historical data; businesses can often use historical industry trends and industry data to help them gauge their business performance. Accounting system software such as Xero often uses AI to automate cash flow projections.

#### Steps to create a cash flow projection

There are 7 steps to project future cash flows as accurately as possible, which are similar to the process of preparing cash flow statements:

1. Decide the forecasting period.
2. Identify the opening cash balance.
3. List all cash inflows by collecting data on past cash transactions and cash sales.
4. List all outgoing expenses by collecting data on past cash payments of expenses to accurately reflect cash movements. These are your cash outflows.
5. Calculate net cash flow.
6. Calculate the closing cash balance.
7. Prepare a budget for future cash needs over the next 12 months.

##### Step 1: Decide the forecasting period

Determine how far into the future you want to project your cash flows. This could be monthly, quarterly or annually. To complete the step:

1. Assess your business cycle and choose a period that accurately reflects your cash flow cycles. This could be a cash flow period of 12 months or 3 to 6 months if your business has been in operation for less than half a year. This will act as the historical data that will help you speculate your cash flows for the future. If you have just established your business, you can also use industry data.
2. Choose how far in the future you want to project your cash flows. Your projections could range from the next 2 weeks to 12 months (mature businesses may go even further into 1 to 2 years).

For example, if you have a new start-up business that has been operating for 2 months, you can use those 2 months as a reference to budget and plan for the next 90 days.

##### Step 2: Identify your opening cash balance

Your opening cash balance for the month is the closing cash balance you had at the end of last month. If your business is newly established, your opening cash balance is the amount of cash your business has on hand.

##### Step 3: List all cash inflows

Identify all potential sources of cash inflow. This includes sales revenue, investments, grants and any other income.

How to complete the step:

1. Create a table with columns for each month and rows for each income source.
2. Estimate the expected income for each source based on market research or industry benchmarks.
3. Ensure your account for when the cash is received (for example, after invoices are paid).

Here is an example for EcoGlow Pty Ltd:

Table 22: Cash inflow estimate example

|  |  |  |  |
| --- | --- | --- | --- |
| Cash inflows by month | January | February | March |
| Cash sales | $25,000 | $15,000 | $20,000 |
| Grants | $500 | $0 | $0 |
| Investments | $0 | $0 | $0 |
| Total cash inflow | $25,500 | $15,000 | $20,000 |

##### Step 4: List all outgoing cash expenses

Identify all expected cash outflows for your business operations. This includes fixed costs such as rent and variable costs like utilities. To complete this step:

1. Create a similar table for expenses with columns for each month and rows for each expense type.
2. Estimate monthly expenses based on market research or projections.
3. Include one-off expenses that may occur during the forecast period.

Here is an example for EcoGlow Pty Ltd.

Table 23: Expense estimate example

|  |  |  |  |
| --- | --- | --- | --- |
| Cash outflows | January | February | March |
| Rent | $5,000 | $5,000 | $5,000 |
| Salaries or drawings | $8,000 | $8,000 | $8,000 |
| Utilities | $600 | $600 | $600 |
| Total cash outflows | $13,600 | $13,600 | $13,600 |

##### Step 5: Calculate net cash flow

Determine your net cash flow by subtracting total expenses from total income for each month.

For each month, use the formula:

Net cash flow = Total cash in (income) − Total cash out (expenses)

Then, record the results in a new column in your table. For example, the calculation for January for EcoGlow Pty Ltd is:

* Total cash inflow = $100,000
* Total cash outflow = $5,500

Net cash flow = $100,000 − $5,500 = $94,500

##### Step 6: Calculate the closing cash balance

After accounting for net cash flow, the closing balance indicates how much cash you have at the end of each month (XERO, n.d.).

How to complete the step:

1. Start with an opening balance (initial cash available).
2. For each month, use the provided formula:

Closing balance = Opening balance + Net cash flow

The closing balance of one month becomes the opening balance for the next month.

For example, EcoGlow Pty Ltd's closing balance is $99,500, whereas July's opening balance was $5,000 and net cash flow was $94,500.

##### Step 7: Prepare a budget for future cash needs over the next 12 months

The final cash flow forecast example for EcoGlow Pty Ltd combines all these steps into one readable statement. The following table shows EcoGlow Pty Ltd’s forecast example. All figures are in thousands.

Table 24: Cash flow project example

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Description | Jul | Aug | Sep | Oct | Nov | Dec | Jan | Feb | March | Apr | May | June |
| Opening balance (000) | $10 | $30 | $60 | $100 | $150 | $200 | $280 | $340 | $395 | $445 | $485 | $515 |
| Monthly cash in (000) | $100 | $110 | $120 | $130 | $140 | $180 | $150 | $140 | $130 | $120 | $110 | $100 |
| Monthly cash out (000) | $80 | $80 | $80 | $80 | $90 | $100 | $90 | $85 | $80 | $80 | $80 | $80 |
| Closing balance (000) | $30 | $60 | $100 | $150 | $200 | $280 | $340 | $395 | $445 | $485 | $515 | $535 |

### Change cash flow forecasts

Your cash flow forecasts can and should change over time. For new businesses, planning far ahead can lead to less accurate predictions due to the lack of historical data for estimates. However, external investors and creditors may want a more extended forecast period to understand how well you can repay debt finances or how well your business can maintain cash strategically. It is essential not to be too optimistic about cash flow projections. This can lead to increased expenses and reduced profits if the cash flow does not increase.

In contemporary business management, you can streamline forecasting cash flows using your respective accounting software. Xero, for instance, offers artificial intelligence-driven (AI) analytics to generate short-term cash flow projections of up to 90 days for business owners.

 Video

Review the video [Get started with short-term cash flow in Analytics Plus](https://www.youtube.com/watch?v=conYdwrDoKA) (YouTube, 2:13 min) to find out more information on how Xero automates cash flow projections for up to 90 days.

**Video summary**

* Xero Analytics Plus uses artificial intelligence to predict your cash flow from 7 to 90 days.
* The predictive cash flow can change as you make new updates to the dashboard. These changes could include adding expected payments for outstanding invoices or bills as well as one-off payments.
* You can interact with the predicted cash flow graph to review the sources of cash inflows and cash outflows in more detail.

 Practice activity

### Activity 7: Financial statement purposes

Match the financial statement to its correct purpose. Indicate the correct letter in the answer column.

Table 25: Matching

|  |  |  |
| --- | --- | --- |
| Purpose | Answer | Financial statements |
| Shows the inflow and outflow of cash over a specific period |  | 1. Profit and loss |
| Provides a summary of revenues and expenses over a specific period |  | 1. Balance sheet |
| Displays the company’s assets, liabilities and equity at a specific date |  | 1. Cash flow statement |
| An analysis that determines the point at which total revenues equal total costs |  | 1. Budget |
| Statements that forecast a business’s expected income, expenses and cash flow over a specified period |  | 1. Break-even analysis |

 Practice activity

### Activity 8: EcoGlow Pty Ltd cash flow projection

**Activity scenario:** To ensure they have enough cash for the 2027 financial year, EcoGlow Pty Ltd has prepared a cash flow projection across the 12-month period. The cash flow assumes all figures include GST.

Review the projected profit and loss statement for EcoGlow Pty Ltd over the 12-month period using the tab **Activity 8** [Cl\_Finance\_TL\_Appx\_FnclTmplts (xlsx)](https://share.tafensw.edu.au/share/items/b7ae392b-2e9f-4db3-89a9-0caa32fd7b2e/0/?attachment.uuid=a793926c-2303-41d1-9273-7c7b2f2d4bad). Then select the correct answers to the 4 questions.

1. What is the net cash flow balance for December 2026?

Table 26: Multiple choice

|  |  |  |
| --- | --- | --- |
| # | Choices | Answer |
|  | A positive net cash balance of $25,000 |  |
|  | A positive net cash balance of $101,000 |  |
|  | A negative cash balance of $25,000 |  |
|  | A negative cash balance of $101,000 |  |

1. What does the projected net cash flow balance for December 2026 mean?

Table 27: Multiple choice

|  |  |  |
| --- | --- | --- |
| # | Choices | Answer |
|  | EcoGlow Pty Ltd estimates that it will gain a net cash of $25,000 for the month of December 2026. |  |
|  | EcoGlow Pty Ltd estimates that it will gain a net cash of $101,000 for the month of December 2026. |  |
|  | EcoGlow Pty Ltd estimates that it will lose a net cash of $25,000 for the month of December 2026. |  |
|  | EcoGlow Pty Ltd estimates that it will lose a net cash of $101,000 for the month of December 2026. |  |

1. Why is it important for EcoGlow Pty Ltd to make a cash flow projection?

Table 28: Multiple choice

|  |  |  |
| --- | --- | --- |
| # | Choices | Answers |
|  | It helps EcoGlow Pty Ltd estimate if they have enough cash to cover growth opportunities and future debts for the financial year ahead. |  |
|  | It shows how profitable EcoGlow Pty Ltd is for the next year. |  |
|  | It helps EcoGlow Pty Ltd estimate how much cash they have if they sell off unnecessary assets. |  |
|  | It helps EcoGlow Pty Ltd estimate how much revenue and expenses they will have for the financial year ahead. |  |

1. Why is the closing cash balance for December 2026 equal to the opening balance for January 2027?

Table 29: Multiple choice

|  |  |  |
| --- | --- | --- |
| # | Choices | Answer |
|  | The closing balance and opening balance are the same by coincidence as they do not relate to one another. |  |
|  | The closing balance for December 2026 shows how much cash EcoGlow Pty Ltd has up to that point. It then becomes the opening cash balance for the next month. |  |
|  | EcoGlow Pty Ltd had the same amount of cash sales for both months which resulted in identical cash balances. This is because they have the same clients each month ensuring they always have the same cash sales. |  |

## Prepare financing strategies

A robust financing strategy ensures long-term success and sustainability in today's competitive business landscape. A well-crafted strategy outlines the financial requirements necessary to support growth initiatives and identifies the most suitable sources of capital, whether through grants, equity financing or debt options.

### Sources of liquidity

Before a business prepares a financial strategy, it should identify sources of existing liquidity – that is, all the ways it can access readily available cash to cover its short-term liabilities. Identifying sources of liquidity that can fund your business goals, objectives and workplace procedures is a fundamental aspect of effective financial management.

For most small businesses, there are primary and secondary sources of liquidity.

* **Primary sources of liquidity** – Funds that can be converted into cash and cash equivalents quickly. This includes any existing cash and cash equivalents you have on-premises or in your bank account, short-term investments that can be quickly liquidated or any accounts receivable amounts that can be quickly collected.
* **Secondary sources of liquidity** – Funds that are less immediate or more difficult to obtain. This can include selling non-essential equipment or loans to other financial institutions.

Understanding your business’s limitations in obtaining liquidity will allow you to choose the most appropriate financing strategy.

### Financing strategies

There are 3 main financing strategies that businesses employ to obtain finance:

* debt finance
* equity finance
* grants.

Each has advantages and disadvantages, as well as costs, which is why many businesses use a combination of 2 or more financing strategies.

### Equity finance

Equity finance is where an individual or organisation agrees to provide funds in exchange for equity or part ownership of the business. This means that instead of borrowing money from the bank to fund your business, you can invest your own money or someone else's. The amount of money an external investor finances is proportionate to their ownership of your business and your share of profits.

#### Advantages of equity finances

Equity financing tends to be less risky than debt financing because businesses do not carry a burden of debt. This means that the business does not need to make recurring payments or pay interest, which is helpful for small and new businesses. Equity financing will also mean that you'll have more cash for capital. Investors are often willing to provide additional funds if the business performs well and provides good returns.

Beyond money, equity financing can benefit the business through the contacts and networks that you may develop. Investors such as business angels may bring valuable experience, skills, contacts and credibility, all of which may prove beneficial as the business continues to expand.

#### Disadvantages of equity finances

Generally, under equity finance, you will have to give up some ownership and control of your business in exchange for investment funds. Your investors will have a say in how to run the business and while this may have its advantages, you need to consider how much control you surrender. For instance, giving away a third of your business in exchange for investment would give an investor considerably more say in significant business decisions, including non-financial areas such as your employee base, operations and marketing strategies.

Sourcing equity financing isn't necessarily straightforward. Approaching investors takes a lot of time and money, which can impact your business. You should also carefully consider your relationships if you accept investment funds from family or friends, particularly if the business fails.

#### Examples of equity finance

Examples of equity finance are:

* **Crowdfunding** – This has become more common in recent years with the rise of the internet and social media. It raises money by using online networks to contribute to a project, often in exchange for a small good, service or equity. Crowdfunding can be a good method if you already have strong networks or a loyal customer base.
* **Bootstrapping** – This is a way for a small business to finance its operations without borrowing large amounts of cash. Characteristics of a bootstrapped business include growth through immediate earnings, minimal overheads such as a start-up business that operates from the founder's garage, use of credit cards and advances from customers, use of networks such as selling products through direct sales, leasing equipment, multiskilling – for example, the CEO is also the salesperson.
* **Business angels** – These are individuals or businesses that invest in new or expanding businesses. In exchange for their money, skills or contacts, business angels may wish to be involved in the business, either as mentors or directly.
* **Venture capital** – Venture capital businesses will provide funds for the research and development of a business idea, businesses in their early stages and business expansion. Venture capital businesses tend to focus particularly on start-up businesses with the potential for rapid growth and high rates of financial return.
* **Family and friends of the business owner** – Getting friends and family to invest is another method of gaining capital for your business. This method can be a quick and easy option but there is always a high risk associated with doing business with friends or family. Any business transaction should have a contract drawn up, so everything is clearly outlined, covering all terms for every party.

### Debt finance

Debt financing involves borrowing funds that are paid back with interest within an agreed-upon timeframe. Debt finance is where a business raises funds through a third party who agrees to lend money to the business. This money is to be used for the business needs.

Examples of debt financing in Australia are:

* bank loans
* overdrafts (a credit agreement that businesses can access when they are too short on funds to cover expenses).
* mortgages
* credit cards
* equipment leasing or hire purchase.

In return for lending the money, the lender becomes a creditor and joins a contractual arrangement so you will need to repay them. The payment includes the principal as well as interest on the loan. With this method, you must show sufficient documentation to the creditor that you can feasibly repay the loan.

It can be difficult to secure debt financing. Banks are conservative when lending money and will not offer you a loan if they consider the risk to be too high. Newly established businesses that lack sufficient financial documentation such as profit and loss statements, balance sheets and cash flow statements will often find it more difficult to secure debt financing because it can be challenging to gauge how well the business performs. In such cases, it is best to seek assistance from a specialist, such as a finance broker, who can help your business navigate loan options.

#### Advantages of debt finances

Debt financing allows you to maintain ownership and complete control over your business without answering to investors. Similarly, it will enable you to retain all your business's profits rather than sharing them with stakeholders. You can also get tax deductions on debt financing. Unlike private loans, interest fees on a business loan are tax deductible.

#### Disadvantages of debt finances

#### Debt financing can be risky in certain circumstances. You must be confident that your business can generate enough cash to pay the debt and interest. If your business fails, you are still obligated to pay the debt.

If you fail to make your repayments on time, your credit rating will be affected and your ability to secure future loans may be affected. You are also exposed to the risk of bankruptcy if you do not keep up your loan repayments. Your loan may also be secured against collateral such as the assets of the business or your personal assets.

### Grants

Grants are financial awards given to businesses to support specific projects or initiatives. Grants and assistance programs are usually given by federal, state or local governments to small businesses but they can also be provided by other financial institutions. Grants are neither a form of debt financing nor equity financing – they do not require the business to repay the value of the grant itself, they do not require an exchange of partial ownership and they do not require investment returns.

Grants often have eligibility criteria that you will need to meet to apply. You can search a database of grants on the Australian Government's [Grants and programs finder](https://business.gov.au/grants-and-programs) webpage.

#### Advantages of grants and assistance programs

Grants and assistance programs typically will only have a one-off cost when you apply; they do not require the business to meet additional debt or equity obligations. Government grants and assistance programs can also help cover start-up costs for new businesses, which means they can focus their time and resources on other financial objectives.

In some circumstances, grants can be prestigious due to a competitive application process. With many businesses competing for a single grant, obtaining one can boost your business's credibility and reputation with other customers and investors.

#### Disadvantages of grants and assistance programs

Grants are mainly a short-term solution for businesses due to their set value and they are often resource intensive in other ways. As competition for grants can be intense, businesses usually need lots of time to go through a lengthy application process to outline their eligibility, prepare their financial documents and explain how they will use the grant and for what purpose. The approval process can be lengthy and has no guarantee of success, which means that if the business is currently in operation, it will need to find other methods to gain more capital.

 Practice activity

### Activity 9: Debt or equity finance

Review the statements carefully and indicate **Debt** or **Equity**.

Table 30: Debt or equity finance

|  |  |
| --- | --- |
| Finance type | Debt or equity |
| 1. Business credit card |  |
| 1. Overdraft |  |
| 1. Bank loan |  |
| 1. Crowdfunding |  |
| 1. Selling shares |  |
| 1. Cash from the owner or family or friends |  |
| 1. Personal loan |  |

## Assess the cost of getting finance

Researching and assessing the cost of securing finance is critical for businesses that aim to enhance their financial stability and growth potential. This process involves owners thoroughly evaluating various financing options, including debt and equity, to determine the most cost-effective solutions that align with the business's strategic objectives.

### Costs of securing finance

When securing finance for your business, you need to research and evaluate your financing options against your existing goals. No matter what type of finance you decide to use, you must ensure that it matches your business plan and meets optimal terms for your business structure.

### Bank loans

The most common way of sourcing finance for your business is to apply for a business loan from a bank. To do this, you must have a detailed plan for your proposed venture.

When applying for a bank loan, you should consider:

* how much you need to borrow
* the type of loan you need
* how long you need the loan for
* whether the business can afford to repay the loan
* what security can you offer the lender.

You also need to ensure that your loan provides the correct type of finance for your business needs. If you need all the funds at once, you will require an 'upfront' or 'fully drawn advance' loan, which is more suitable for businesses that require money to buy a new property or equipment.

Bank loans always incur interest. The longer the term of the loans, the more total interest you will pay, so you should think carefully about your repayment schedule. Interest rates can also be fixed or variable. With a fixed-rate loan, the lender bears the risk of interest rate changes, whereas, with a variable rate, you will bear this risk. There is not necessarily a right or wrong choice of a loan; it depends on the state of the economy and how much free cash your business generates after you have paid all your expenses. If your business is not generating adequate profit, a variable loan repayment might be risky since the interest rate may rise beyond your ability to pay.

When deciding on a bank loan, there are many things you need to be aware of. Create a checklist that details your business needs, so you know what to look for when approaching a lender.

Here is a range of features and considerations:

Table 31: Features and considerations

|  |  |
| --- | --- |
| Loan features and considerations | Examples |
| Accessibility | * Phone and internet banking * Mobile or physical branches * Automated teller machine (ATM) access |
| Interest options | * Interest only versus principal and interest * Interest paid in advance * Variable versus fixed rate * A split loan (a combination of fixed and variable portions) |
| Repayment options | * What schedule works best for payments (weekly, fortnightly, monthly) * Repayment amount |
| Fees and charges | * Establishment or exit fees * Fees for late payments * Monthly fees * Valuation fees * Fees for additional lump sum payments |
| Other loan features and benefits | * Optional redraw facilities * Portability * Progressive drawdown * Additional repayments * Flexible repayment options |
| Additional costs | * Third-party services – conveyancer, accountant * Reputation of lender * Compulsory insurances * Stamp duty * Deposit |

When you start to analyse all the numbers you get from various lenders, you need to know how to calculate how much you end up owing. This gives you the advantage of comparing the costs and benefits of each lender. All loans will incur interest, so it is essential to calculate the interest you owe to the lender accurately. Interest can come in 2 different forms – simple or compound interest. When calculating interest, there will be several different terms used in formulas.

Table 32: Financial terms

|  |  |  |
| --- | --- | --- |
| Term | Symbol | Definition |
| Principal | **P** | Amount of loan or initial deposit |
| Interest | **I** | The dollar amount charged by the lender |
| Interest rate | **R** | A percentage rate, expressed as a per annum (yearly rate) |
| Term | **T** | The agreed period of time the borrower has to repay all of the principal and attached interest OR period of investment |
| Future value | **A** | Sometimes called 'accumulated amount' |
| Number of repayments | **N** | Number of loan repayments during the term |
| Loan repayment | **L r** | Dollar amount to be repaid per loan period: principal (part) and interest |

#### Simple interest

Simple interest is the easiest type of interest to calculate but it is only worked out on the principal amount.

The formula for simple interest is I = P x R x T

Note that when using interest rates in calculations, always enter it as a decimal. For example, enter 0.07 when the interest rate is 7%.

#### Compound interest

Compound interest is calculated based on the ending balance for the previous period and added to the original amount, assuming no repayments have been made during the financial period. In other words, interest is calculated based on the interest earned. This continues for however many periods over the term of the loan.

To calculate compound interest, we calculate the interest for the first period and add it to the loan amount. Then, we calculate the interest based on that ending balance (instead of the original amount with simple interest). We add that portion of interest to the loan amount and we again calculate the interest based on the ending balance for the second period. This goes on for however many periods there are in the life of the loan.

Sometimes interest can be compounded daily, as is the case with credit cards. Loans are usually calculated on an annual basis. If the interest is compounded on anything less than a year, you need to use the per annum rate and divide by how many periods in the year.

For example, if we were calculating credit card interest on a daily basis, we would need to use the per annum (yearly) interest rate and divide by 365 (or 366 if it is a leap year) days in the year.

#### Interest-only

If you choose an interest-only loan, it means that you are only paying the interest on the amount borrowed. Repayments for interest-only loans will always be less because you are not paying back any of the principal (amount you borrowed).

When using this method, your total liability will always be the amount that you have borrowed and it will not reduce. This can be disadvantageous because you are not reducing the total amount you owe. This method is usually only advantageous if the loan is to generate income, as you may be able to claim the interest portion on tax. You are unable to claim the principal repayments on tax.

#### Government grants

Government grants may not require repayment. However, applicants might encounter costs related to the application process and find compiling the necessary documentation to ensure they meet the eligibility criteria time-consuming and human resource-intensive.

#### Venture capital

Venture capital is a form of equity financing offered by the government. Unlike government grants, venture capital can lead to partial equity dilution, meaning that the original owners may lose some control over their business as they share ownership.

#### Crowdfunding

Crowdfunding generally involves small contributions from many individuals. However, platform fees may apply, typically ranging from 3% to 5% of the total funds raised. There is also no set time limit or guarantee that a business can reach its funding goal, meaning that crowdfunding is often not a reasonable solution for businesses that face liquidity issues.

## Assess financial strategies for future changes

As you carry out your financial strategy, you may realise that it requires changing due to internal and external forces. You may find that your business needs more finance to scale itself and that your current financing strategy is insufficient or your business may face a cash shortfall and struggle to pay back its debts. You may find that market conditions have decreased sales over a specific period or that inflation has increased your production costs and profit margin.

As a business owner, you must closely monitor the implementation of your business plan and financial strategy. Where practical, contingency plans should be in place for staff departures, unforeseen leave, system failures, bad debt and anything that can impact your business financially.

Better-practice entities should implement some or all of the following:

* Track activity progress against the schedule. For example, check if planned activities, meetings and critical milestones are occurring on time. As the schedule changes, provide the updated schedule to relevant stakeholders.
* Provide timely advice and guidance to the finance team and business areas.
* Build quality checks, such as reviews of supporting documentation and working papers at critical milestones.
* Maintain contingency plans, such as using backup or temporary staff or reaching a prior agreement with staff to work overtime.
* Address significant issues promptly, consider their impact and implement corrective action.

The next sections discuss specific activities that may be required to implement and monitor the project plan and coordinate matters to improve an entity’s ability to prepare financial statements effectively and efficiently.

### Monitor progress

Owners should closely monitor their project plans and schedules on an ongoing basis and progress against the schedule should be regularly reported to the owner or leadership. Monitoring should involve recording the completion dates for critical events to compare against planned dates and revising the schedule as necessary. This captures useful information to inform project scheduling for future years.

The audit committee should be regularly informed of progress against the plan and the accountable authority should be periodically briefed, as required.

### Review project risks and treatments

Risks change over time and hence, risk management will be most effective where it is dynamic and evolving. Key objectives of risk monitoring and review include:

* detecting changes in the internal and external environment, including evolving entity objectives and strategies
* identifying new or emerging risks
* ensuring the continued effectiveness and relevance of controls and the implementation of treatment programs
* obtaining further information to improve the understanding and management of already identified risks
* analysing and learning lessons from events, including near-misses, successes and failures.

## Create and manage credit policies

The last step in financial planning is contingency management, which involves considering proactive strategies to manage and minimise unexpected financial challenges. By creating a credit policy, you can provide a safety net for your business's cash flow.

A business credit policy stipulates what would happen if your customers failed to meet their trade obligations, for example, if they don't pay on time. An effective credit policy aligns with your business goals and could help you manage cash flow. It also reduces the chance of accumulating bad debt and write-offs.

### Processes and procedures

A sound credit policy will ensure consistency across your account portfolio and help lead to stable and predictable cash flow. By documenting processes and procedures, you can minimise the debt risk to your business. The first step in establishing the parameters of your credit policy is to understand just how much credit your company can afford to extend. You need to consider your business, industry, location and average credit extended so that you can begin by setting a standard for certain criteria and milestones.

### Terms and conditions

Different types of orders for different types of products require their own terms of sale. Which accounts pay on time, pay late or don’t pay at all? Days sales outstanding (DSO) is a ratio measuring the average number of days that a company takes to pay its invoice. It’s calculated for a given period by dividing accounts receivable by total credit sales and multiplying the result by the number of days.

There are specific terms used in creating and maintaining credit policies. These include:

* credit terms
* credit limits
* credit standards
* collection procedures
* risk management.

Table 33: Credit policy terms

|  |  |  |
| --- | --- | --- |
| Terms | Meaning | Example |
| Credit terms | The conditions under which credit is extended to customers, including the duration for which credit is available and the payment schedule. | Net 30 days payments are due within 30 days from the invoice date. |
| Credit limits | The maximum amount of credit that can be extended to a customer. This limit is determined based on the creditworthiness of the customer and helps manage risk by setting boundaries on how much credit can be used. | Supplier credit limit is a business that is a supplier for other businesses that can offer a credit limit of up to $20,000. This means other businesses can purchase inventory on credit up to $20,000. |
| Credit standards | The criteria for evaluating potential customers' creditworthiness before extending credit. This includes assessing their financial stability and payment history. | This could include looking at financial statements or credit scores to evaluate a customer’s ability to pay on time. |
| Collection procedures | The steps and processes for collecting payments from customers who have overdue accounts. This includes methods for following up on late payments, negotiating payment plans and potentially involving collection agencies if necessary. | Examples of credit collection procedures:   * Issue an email that informs the customer or debtor of their outstanding amount and payment options available. * Issue a default notice to the customer of their default status and timeframe to rectify the situation (usually at least 30 days). * If the customer still has not responded, the business may inform them again and engage with third-party collectors. |
| Risk management | The strategies and practices to minimise potential losses from extending credit. This includes monitoring customer accounts, assessing market conditions and implementing policies to mitigate risks associated with credit sales. | These strategies could include conducting thorough checks, establishing clear and realistic credit limits and implementing credit policies. Some businesses also purchase trade credit insurance to protect themselves in the case of a customer default. |

### Accounts receivable

Accounts receivable is money owed to your business by customers that buy on credit, in other words, customers that will pay cash later. It is important to understand the ramifications of allowing customers to pay later. You then run the risk of them not paying at all.

It's important to understand the business cash flow impacts of allowing a customer to pay for items they have purchased later. Receiving money from customers quickly means you have more money as cash flow. This means you can purchase more items for your business to keep the operating cycle flowing.

### Operating cycle

An operating cycle refers to the length of time a business takes to buy inventory and then sell it in exchange for cash. It is important to manage cash well during the operating cycle by ensuring that suppliers are paid on time and customer payments are received promptly. As such, businesses that offer credit to customers must create policies to protect themselves. Contracts are often in place when purchasing from suppliers, ensuring suppliers receive payment in a timely fashion. The same goes for when businesses sell to customers.

Even though your business might operate as a cash business when you report your GST, you still allow some customers to pay you later than when you provided them with the goods or services. Therefore, managing your accounts receivable payments is essential so you can collect the money promptly. If you have customers that you allow to pay later, you need to be able to run an accounts receivable aging report so you can check how much is due from each customer in specific periods.

### Implement client credit policies

Implementation of a client credit policy is an essential component of a successful business to help with good credit management. When there are policies in place, both the business and the client are aware of their obligations in repaying a debt. When a client makes their repayments on time this maximises the cash flow of the business as you then have the funds required for your own financial obligations.

The following are required for a good client credit policy:

* Clearly define your terms of trade.
* Assess customers by capturing the information required for an application.
* Secure the debt.
* Have a system to record payments to provide the customer.
* Have a plan in place to collect any bad debt.
* Outline how customers pay for your goods and services and when you expect payment is important to protect your business cash flow.

### Payment terms

These outline how customers pay for your goods and services and the details of when you expect payment. Payment terms will vary from business to business and generally refer to the payment methods you will accept, whether you provide credit and the terms of credit and your debt collection policies.

Payment terms are part of a sales contract in Australia and so operate under contract law. Failure to comply with the agreed payment terms is a breach of contract. Payment methods typically used by small businesses include:

* cash
* cheque
* electronic funds transfer at point of sale (EFTPOS)
* credit and debit cards
* electronic bill payments (BPAY) or online payments
* vouchers and gift cards
* direct debit.

Goods and services can be paid for upfront or on delivery or are supplied on credit (where payment is deferred for a period of time after the goods or services have been supplied).

* Offering credit increases your risk of being paid late or not at all, so for customers you don’t know well, consider upfront or on-delivery payments, also in situations where you have outlaid large amounts of money to supply the goods or service.
* Your approach will vary depending on your business needs and cash flow requirements. Some businesses only accept payment on delivery and do not provide credit, while others offer both.
* Standard terms of credit are often 7, 21 or 28 days. Your payment terms should be stated on all invoices.

If you provide credit, it is advisable to develop a credit application process to screen customers and avoid those with a poor credit history.

### Credit application process

Before providing credit to a customer, it is important to check their creditworthiness. Businesses often provide a credit application form as a form of verification and will include information regarding:

* the full contact details of the applicant
* their ABN, business structure, details of the directors, partners or owners (if dealing with a business) and trustees
* contact details for at least 3 supplier referees
* a signature confirming that they have read and understood your terms and conditions and agree to abide by them
* the applicant’s permission to conduct a credit check.

If a company is seeking to apply for credit, you may want to consider obtaining a directors’ guarantee (include this request in the application form). This means if the company gets into financial difficulties, you can hold the directors liable for the debt.

### Maintain client credit policies

You will need to consider how your organisation's credit policies affect your cash flow. Strict credit policies may lose sales from potential customers and ultimately reduce cash inflows. However, policies that are too relaxed will lead to difficulties in collecting money from customers, which will lead to revenue problems. Credit policies should help attract good customers without affecting your cash flow.

Your credit policies should include:

* records of the client's credit history with the organisation
* plans and timelines to recollect from clients, for example, sending invoices and giving clients 28 days to pay
* repayment methods clients can use.

Credit options and recovery plans will vary depending on the type of business and customer base. For example, dozens of customers with small debts will need to be handled differently than a few customers with large debts.

Guidelines for maintaining credit policies include:

* Establish your credit policies concerning your business's cash flow needs; don't let the business become overextended.
* Build credit facilities into your business plan.
* Review and adapt credit policies; use failures to recover money as learning experiences to improve them. Always consider whether the policies are meeting your and your clients' needs.
* Make records of which customers are good credit risk to improve your decision-making. Introduce variable terms that offer flexibility to those who are good risks and less flexibility to those who are not good risks.
* Take the economic conditions of the local or national market into account when developing and implementing policies.
* Ensure all employees are aware of credit policies and any changes that are made to them. If employees offer a credit to a customer on incorrect terms, it won't be able to be corrected afterwards. Therefore, employees must always know these terms.

### Monitor credit policies

When providing credit, ensure that you invoice regularly. Monitor your debtors closely so that you can follow up on overdue payments and do not allow customers to exceed their credit limit. Where a client has defaulted on their agreement, there should be a policy that stops the client from obtaining additional credit.

Carefully manage your debtors and creditors to ensure steady cash flow in and out of your business. You may need to:

* follow up on overdue accounts
* develop good credit policies to keep cash coming in
* negotiate longer payment terms with suppliers
* time your invoices and payments so you receive payments from customers before you have to pay suppliers.

### Debt collection

In the case that a debtor fails within the credit term, a business will then proceed with their established debt collection procedures. This can include using a third-party debt collection agency or contacting the debtor directly. If your business contacts the debtor directly, there are 2 important things to consider:

* **Privacy** – It is always important to verify the identity of the debtor before discussing any debt-related information. Under Australian law, debt collectors must protect the personal information of debtors and third parties.
* **Timeliness** – Contact with a debtor should be limited to 7:30 am to 9 pm on weekdays, with a maximum of 3 phone calls a week. Under Australian law, it is a business risk to unwittingly harass debtors, use coercion or otherwise misconduct.

When your debtors fail to pay you, you must record it as bad debt or a write-off. Write-offs are expenses caused by uncollectible profit or debtors defaulting on their loan to you (bad debt) and can reduce your accounts receivable account. Both bad debts and write-offs are part of contingency planning, so it is important your business monitors its credit policies proactively.

 Resources

For further information on how to conduct debt collection appropriately, refer to the Australian Competition and Consumer Commission (ACCC)’s resources on [What debt collectors can and can’t do](https://www.accc.gov.au/consumers/debt/what-debt-collectors-can-and-cant-do).

 Self-check

### How did you go?

You have completed the lesson: **Prepare and plan finances**. Check the boxes for the tasks you feel confident you can complete.

I can identify product and service delivery costs and set profit targets.

I can calculate charge-out rates and unit prices.

I can perform a break-even analysis and choose a suitable pricing strategy.

I can prepare a financial plan, including projected profit and loss statement.

I can identify working capital needs and prepare financing strategies.

I understand legal and tax requirements.

I can assess the cost of getting finance and assess financial strategies for future changes.

I can create and manage credit policies.

**Lesson 2:**Manage finances

## Overview

Once a business has prepared a financial plan, it must implement it to evaluate its effectiveness in managing its finances. As the competitive landscape is ever-changing, it is not uncommon for financial plans and goals to change over time due to internal and external factors.

By learning how to monitor ongoing financial performances through specific financial metrics, communicate financial information to relevant stakeholders and identify any other resource gaps between your financial plan and your business’s financial needs, your business can manage its funds more successfully to reach its business goals.

In this lesson, you will learn to:

* communicate financial information to others
* identify needs for non-current assets
* identify capital investment needs
* set budget targets to track financial performance
* monitor financial performance using systems
* evaluate how marketing and operations impact finances
* assess financial ratios against industry benchmarks
* adopt new technologies to improve profits.

## Communicate financial information to others

If you are working with a team, monitor their progress on certain tasks to ensure that deadlines are met. Regular meetings with personnel to check progress are a way to address any issues ahead of time and avoid delays.

To ensure that the business plan you have developed will be established in the business, you must make sure that you effectively communicate the content of the plan to relevant personnel. You generally would conduct a meeting to discuss the content of the plan.

To be able to discuss the document with competence, do these before the meeting:

* Review the document.
* Make an outline of your presentation.
* determine how you want to start and close your presentation.
* Encourage the audience to ask questions about the plan discussed.
* Verify with the audience if they understood what you have discussed.
* Answer the queries of the audience with confidence and in a straightforward manner.

To have a successful meeting, you can follow these measures prior to the meeting as preparation:

* Review the document.
* Ask experts from other fields for clarifications and assistance.
* Prepare and take note of possible questions so that you can prepare for the answers ahead of time.

Tasks may also be delegated to relevant personnel. The plan and schedule should be monitored closely on an ongoing basis and progress against the schedule should be regularly reported to the chief financial officer (CFO) and other members of the finance team. Communication can take many forms, such as workshops, telephone calls, emails, memos and conferences.

### Create clear financial procedures

To facilitate the implementation of a business plan, small businesses must develop comprehensive financial procedures that align with workplace policies. These procedures should include:

* **Documentation requirements** – Small businesses must maintain accurate records of all financial transactions, including income, expenses, payroll and tax-related documents. This means keeping records for at least 5 years (ATO) but up to 7 (ASIC), as mandated by each regulatory body and can be supported by automated accounting systems such as Xero.
* **Standard operating procedures (SOPs)** – Create SOPs that outline step-by-step processes for financial tasks such as invoicing, expense reporting and payroll management. This ensures consistency and compliance across the small business.

### ****Record financial transactions****

Accurate record-keeping is essential for transparency and accountability. Key records to maintain include:

* **Employee records** – Document details such as employee names, payment rates, hours worked and deductions.
* **Transaction records** – Keep detailed records of all sales, purchases and other financial transactions to support audits and tax filings.
* **Financial statements** – Regularly prepare profit and loss statements and cash flow forecasts to monitor the financial health of the business.

### ****Communicate procedures effectively****

Communication is vital in ensuring that all personnel understand their roles in implementing financial procedures. Strategies include:

* **Training sessions** – Conduct regular training sessions to educate employees on financial policies and procedures. This helps ensure they are aware of their responsibilities and the importance of compliance.
* **Accessible documentation** – Maintain a centralised repository of financial policies and procedures that employees can easily access. This could be a digital manual or an intranet site.
* **Simplified language** – Use clear and straightforward language when communicating financial information. Avoid jargon that may confuse non-financial staff, making it easier for everyone to understand their roles in the financial processes.
* **Communication modes – Businesses should ensure they use the appropriate mode of communication in presenting financial information to different stakeholders. For example, you can use email to communicate direct interactions with your employees or external clients but it is an unsuitable mode to communicate your business’s financial position and full business plan. The 4 common modes of communicating procedures are:**
* emails
* in-person meetings
* reports
* presentations.

Table 34: Communication modes

|  |  |
| --- | --- |
| Communication mode | Description |
| Email | A common tool for sharing financial information quickly and efficiently. It allows professionals to send updates, reports and inquiries while maintaining a written record of communication. |
| In-person meetings | Involve direct interaction between financial advisors and clients. These meetings help build trust and allow for in-depth discussions about financial matters. |
| Report | Structured documents that present financial data and analysis in a clear format. They summarise important information, helping stakeholders understand the financial status of a business or project. |
| Presentation | Uses visual aids, like slides, to communicate financial information to an audience. They are effective for explaining complex concepts and engaging stakeholders in discussion. |

 Resources

You can access Xero’s presentation on [Investor briefing (pdf)](https://brandfolder.xero.com/8HSCTPAX/as/hq2q4n3k38qmfts5xvjvf6/Xero_Investor_Deck_H1FY25) for the first interim of their 2025 financial year (FY25) to review an example of a formal business presentation that is targeted towards investors.

You can access Xero’s [Interim report FY25 (pdf)](https://brandfolder.xero.com/8HSCTPAX/as/n9kkcg6jb8nh9qn59b8fg64/Xero_Interim_Report_H1FY25) to review an example of what a financial report may look like and how it differs from a presentation.

Note that in both cases, the documentation level is much more complex than most small businesses due to Xero’s large business structure. There are additional laws in Australia that determine whether small businesses need to prepare annual reports for legal compliance depending on their legal structure.

### ****Monitor for compliance****

To ensure adherence to financial procedures small businesses should implement various monitoring mechanisms:

* **Regular audits** – Conduct periodic audits of financial records to identify discrepancies or areas for improvement in record-keeping practices.
* **Feedback mechanisms** – Establish channels for employees to provide feedback on the financial procedures. This can help identify potential issues or areas where additional training may be needed.

## Identify needs for non-current assets

To optimise financial performance and ensure sustainable growth, it is essential for businesses to determine their non-current asset needs and explore effective management options that align with their strategic objectives.

### Non-current assets

An asset is an item, thing or entity that has potential or actual value to a business.

Non-current assets are assets that represent a longer-term investment where the full value will not be realised within the accounting year. Non-current assets are illiquid, meaning that they cannot be converted easily into cash or cash equivalents within 12 months.

Depreciation is the value of how much an asset has lost over time. The expense allowance is the amount of depreciation for that particular time period, whereas the accumulated depreciation is the total amount over the life of the asset to date.

Information about how quickly assets can be converted into cash is essential for analysing the liquidity of a business. Moreover, since non-current assets generate financial benefits over longer periods of time, they will likely depreciate over their useful lives. On a balance sheet, you should differentiate between current and non-current assets.

On the balance sheet, depreciation associated with the asset itself is represented as a contra account but is still shown in the non-current assets section.

Non-current assets may include:

* investments in other businesses
* intangible assets such as brand recognition or intellectual property, where the full value will not be realised within the financial year
* property
* plant
* motor vehicles
* furniture and fixtures
* equipment
* building
* accumulated depreciation associated with the particular asset.

### Asset management strategies

Asset management is the coordinated activity of a business to realise value from assets. It involves balancing costs, opportunities and risks against the desired performance of assets to achieve organisational objectives. Depending on the type of assets, this balance might need to be considered over different timeframes. Asset management is the art of making the correct decisions in relation to your assets and optimising the delivery of value.

A common objective is to minimise the entire life cost of assets. However, other important factors, such as risks, may need to be considered objectively in the decision-making process.

A good asset management strategy would be to invest in top-of-the-range, high-specification equipment if it is an essential piece of machinery in your production line. Although initially, the cost of this purchase will be high, you will benefit in the longer term. The maintenance costs should be lower; the equipment should last longer, there is a lower likelihood of the machinery failing and disrupting production and health and safety risks may be lower. This strategy demonstrates that you have reflected on the overall lifecycle of the asset.

On the other hand, reducing the regularity of maintenance on an asset would be a bad asset management strategy. Although this might have a financial benefit in the short term, it may ultimately lead to the machinery failing prematurely, which would impact the production line and could also prove to be dangerous to your staff.

Asset management is important because it:

* reduces the total costs of operating business assets
* reduces the capital costs of investing in assets
* improves the operating performances of assets
* reduces the health and safety risks of operating assets
* improves the performance of the business
* reduces the legal risks associated with operating costs.

### Asset lifecycle

Understanding the lifecycle of assets is crucial in being able to devise strategies to manage them.

There are 4 main stages in the asset lifecycle.

#### ****Stage 1: Acquisition****

Acquisition covers every stage throughout the planning, designing and procuring of an asset.

#### ****Stage 2: Commission****

Commission covers the process of installing, creating or building the assets and ensuring that the assets are fully functional. This stage differs from the operation stage because it is generally recognised that there is a higher incidence of failure after initial installation and therefore there needs to be extra oversight during the initial operation of the asset.

#### ****Stage 3: Operation****

The operation stage covers most of the asset's life cycle. This is where the asset should provide the function for which it was designed. During the operational period, the asset should be subject to appropriate and regular monitoring, maintenance, refurbishment and upgrades to meet any changes in condition or operational requirements.

#### ****Stage 4: Disposal****

Disposal is often the most overlooked phase of an asset's lifecycle since the asset may last decades. The main activities in the disposal stage include effectively removing the asset from operation, disposing or recycling an asset or its various components and subsequently providing feedback on planning for replacement assets (if required).

### Purchase assets

All businesses need assets to operate, so it is important to understand how to acquire the assets for your business in the most cost-effective manner. The decision about which method to use will mostly depend on cash flow and the length of time you are planning on holding that asset. Each business is unique, so the decision to either buy or lease needs to be made on a case-by-case basis.

There are 2 main methods of purchasing assets for your business:

* buying
* leasing.

#### Buying assets

Buying an asset means that you own it outright, meaning you have used cash or other forms of payment to take ownership. Having ownership of an asset can help with tax breaks, such as depreciation. Buying an asset gives the owner full control of the asset and means there are no constraints with using that asset.

Remember, depreciation applies to the diminishing value of the asset over that period. It does not reflect the true value of wear and tear. It is a contra account, reported in the assets section of a business's balance sheet.

If the asset appreciates over time, you can sell it for more money than it's worth. This profit needs to then be reported on the business's income statement.

Here are the advantages and disadvantages of buying assets:

Table 35: Advantages and disadvantages of buying assets

|  |  |
| --- | --- |
| Advantages | Disadvantages |
| * You take ownership immediately, which allows you to build equity in its value. * You can claim depreciation. * If it is not an asset that will become outdated, you could make a profit upon resale. * You have full control over what you do with the asset. | * Higher initial costs. * If taking out a loan, the full loan amount is regarded as a liability. * Technology will become obsolete in a shorter period of time and will be worth less upon resale. |

#### Leasing assets

Leasing an asset allows the business to stretch smaller payments over a longer period to allow for the use of the item. This approach is often taken with assets such as cars, machinery, property, plant and equipment. The term 'leasing' is used interchangeably with 'renting' – it is similar to individuals renting a house. All payments that are made in the lease are tax deductible, as long as the asset is being used for the purpose of achieving an income. This means business owners can still take advantage of tax breaks.

A simple way of looking at leasing is reviewing it as similar to having a bank loan: there are fees to pay and other administrative costs associated with the lease itself.

There are 3 important terms to be familiar with in relation to leasing:

* **lease** – a contractual arrangement that outlines certain conditions that the lessee can use the asset from the lessor
* **lessee** – the person or business who hires or rents the asset
* **lessor** – the owner of the asset that grants someone else a lease.

Here are the advantages and disadvantages of leasing assets:

Table 36: Advantages and disadvantages of leasing assets

|  |  |
| --- | --- |
| Advantages | Disadvantages |
| * Less initial cost (may involve a deposit). * Costs are smaller and spread over a longer term. * You can claim depreciation. * Easier to obtain and terms can be negotiated. * Upgrade of equipment can be done easily as you can swap one item for another. | * The overall cost is higher as you are paying interest and other fees. * You do not take ownership of the asset straight away – depending on the type of lease, you may never take ownership and, therefore, cannot build equity in the item. * If taking out a loan, the repayments are regarded as a liability. * If you stop using the item, you will need to pay the full lease costs and some leases have early termination fees. |

 Video

Review the video [Understanding leasing vs. buying](https://www.linkedin.com/learning/accounting-foundations-leases/understanding-leasing-vs-buying?u=57684225) (LinkedIn Learning, 3:17 min) for an explanation of the difference between leasing and buying assets and why each method should be used.

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**Video summary**

* Preference for newer cars is often driven by safety and comfort, contrasting with previous ownership of older models like the 1975 Buick Electra, which some consider a classic.
* Leasing vehicles was a common choice for families with multiple children, as it allowed for flexibility in accommodating changing family size and vehicle capacity needs, enabling larger cars to be downsized as children left home.
* Currently, many individuals opt to buy cars when family size stabilises, as this can be more cost-effective in the long run; while leasing offers lower monthly payments, it may not be ideal for those planning to keep cars for an extended period.

### Stock records and stock control



Figure 3: © Shutterstock copied under licence

Stock records and stock control are critical components of effective business management, impacting financial performance, customer satisfaction and operational efficiency. By accurately and closely monitoring and managing your stock, you can improve your inventory accuracy and reduce sunk costs on either missed sales opportunities or slow order fulfilment.

Think about a retail store you might go into. When you ask for an item that you saw on their online store, they have the resources and capacity to check not only if the item is in stock but also when it will be coming back in stock and in the size or colour that you are after.

All of this relates to stock records and stock control management and is essential to meet the demands of your customers.

A stock record is a crucial component of inventory management, serving as a detailed account of all inventory items held by a business. It includes essential information about each item, such as:

* **Description of the item** – This provides clarity on what each stock item is.
* **Quantity available** – The current number of units on hand, which is vital for assessing stock levels.
* **Location** – Where the stock is stored, which aids in efficient retrieval and management.
* **Unique item number or stock keeping unit (SKU**) – Each product should have a unique identifier, known as a stock keeping unit (SKU) or item number. This is crucial for effective inventory management as it simplifies tracking and organisation of products.
* **Cost of the item** – The cost associated with each item; this can also include the purchase price from suppliers.

Stock records can be maintained through various methods, including manual systems, like spreadsheets or digital inventory management software. The choice of method often depends on the size and complexity of the inventory being managed.

#### Importance of managing your stock

Monitoring your inventory can assist you in:

* gaining insight into your stock levels to avoid overstocking or understocking
* recognising items that are not selling well
* identifying instances of theft and discrepancies in your inventory
* determining what products to purchase
* understanding the rate at which your stock is sold and replenished.

**Scenario:**

A local coffee shop, ‘Brewed Awakening,’ has been operating in a bustling neighbourhood for 3 years. Initially, the owner, Sarah, managed inventory manually, relying on her memory and simple spreadsheets. As the business grew, she faced significant challenges in maintaining efficient stock control.

When they opened the store, a popular ‘dog puppachino’ was a top seller with her clients. However, over the years, the infrastructure of the neighbourhood changed to more apartments and fewer homes with backyards, leading to a drop in pet ownership. This change led to a decline in the once-popular dog drink and product spoilage from unused ingredients led to financial strain.

Based on these changes, Sarah could consider reducing her stock re-orders of the ingredients to make the drink and focus on her current best sellers.

#### Stock control methods

Effective stock control is essential for businesses of all sizes, as it directly impacts operational efficiency and profitability. Implementing the right stock control methods can help businesses manage their inventory more effectively, ensuring that they have the right products available at the right time while minimising costs.

There are several established and innovative stock control methods that businesses can adopt, each tailored to meet specific operational needs. These methods include:

* just-in-time (JIT)
* just-in-case (JIC)
* first-in, first-out (FIFO)
* economic order quantity (EOQ)
* vendor-managed inventory (VMI).

##### Just-in-time

Just-in-time (JIT) inventory management focuses on minimising inventory levels by ordering stock only as it is needed in the production process. This approach reduces holding costs and waste, allowing businesses to respond swiftly to customer demand. JIT relies heavily on accurate forecasting and strong relationships with suppliers to ensure timely deliveries.

For example, a small bakery, Sweet Treats, uses JIT inventory management to ensure that fresh ingredients like flour, eggs and fruits are delivered just in time for daily baking. By coordinating closely with local suppliers, the bakery minimises waste from perishable items and ensures that only the freshest products are used in their baked goods, enhancing quality and customer satisfaction.

##### Just-in-case

Just-in-case (JIC) inventory management involves maintaining a buffer stock to mitigate risks associated with unexpected demand surges or supply chain disruptions. This strategy helps prevent stockouts and allows businesses to continue operations smoothly during unforeseen circumstances. While it may lead to higher holding costs, JIC provides a safety net that can be crucial for maintaining customer satisfaction.

For example, an online craft store, Crafty Creations, adopts a JIC inventory strategy by keeping a buffer stock of popular items like yarn and craft supplies. Anticipating seasonal demand spikes during holidays and crafting events, the store ensures it has enough inventory on hand to meet customer needs without delays, thereby preventing stockouts during peak shopping times.

##### First-in, first-out

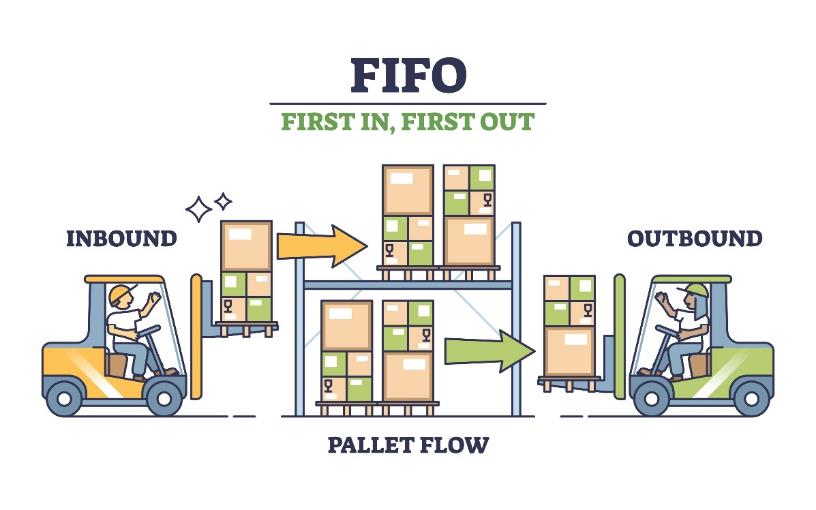


Figure 4: © Shutterstock copied under licence

First-in, first-out (FIFO) is an inventory management technique that prioritises selling the oldest inventory first. This method is particularly important for perishable goods or items that may become obsolete, as it helps reduce waste and ensures product freshness. FIFO is widely used in industries such as food service and retail, where maintaining product quality is critical.

For example, a small organic grocery store, Fresh Harvest, implements FIFO to manage its inventory of perishable goods such as fruits, vegetables and dairy products. By ensuring that older items are sold first, the store reduces waste and maintains product freshness, which is crucial for customer trust and satisfaction in a market that values quality.

##### Economic order quantity

The economic order quantity (EOQ) model determines the optimal order quantity that minimises total inventory costs, including ordering and holding costs. By calculating the most cost-effective quantity to order, businesses can reduce excess inventory and improve cash flow. EOQ is particularly useful for companies with predictable demand patterns and stable costs.

For example, a specialty coffee shop, Brewed Awakening, uses the EOQ model to determine the optimal quantity of coffee beans and other supplies to order. By analysing sales trends and associated costs, the owner calculates the most cost-effective order size that minimises total inventory costs while ensuring they have enough stock to meet customer demand without overordering.

##### Vendor-managed inventory



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Vendor-managed inventory (VMI) is a collaborative approach where the supplier manages the inventory levels at the retailer's location. The supplier uses real-time data shared by the retailer to make informed decisions about replenishment, ensuring that stock levels are optimised without requiring constant input from the retailer. VMI enhances efficiency and reduces costs for both parties involved.

For example, Handyman's Haven, a small hardware store, partners with a local paint supplier who manages the inventory levels of paint products. The supplier monitors sales data and automatically replenishes stock as needed. This VMI approach helps the hardware store maintain optimal stock levels without the hassle of constant reordering, ensuring that popular paint colours are always available for customers.

Choosing the right stock management system is crucial for any business, as it directly impacts operational efficiency, customer satisfaction and overall profitability. The selection process should be guided by the specific products a business sells and its unique business model.

 Practice activity

### Activity 10: Assets and cash flows

Review the questions and select the correct answers.

1. Which 2 assets are considered as non-current assets?

Table 37: Multiple choice

|  |  |  |
| --- | --- | --- |
| # | Choices | Answers |
|  | Factory |  |
|  | Motor vehicle |  |
|  | Inventory |  |
|  | Cash on hand |  |

1. What is the projected closing balance for the start of February if a business expects:

Cash at the start of January: $5,000

Sales revenue in January: $10,000

Sales returns in January: $500

COGS in January: $4,000

Expenses in January: $2,000

Table 38: Multiple choice

|  |  |  |
| --- | --- | --- |
| # | Choices | Answer |
|  | $5,000 |  |
|  | $8,000 |  |
|  | $4,000 |  |
|  | $9,500 |  |

## Identify capital investment needs

To effectively drive growth and ensure long-term sustainability, it is crucial to systematically identify the capital investment needs for each period, aligning financial resources with strategic objectives.

### Manage business capital

Maintaining and preserving capital will require you to continually meet the requirements of your financial backers.

There may be stipulations in place within your agreements. Therefore, you should:

* analyse your business’s strengths and weaknesses and act based on them
* regularly review your financial plans and strategies as the market changes
* embrace opportunities and remain cautious of running out of capital
* monitor your ability to access liquidity and cash
* consult with key stakeholders to get their opinions of your business
* create cash flow plans to prevent sudden cash needs
* manage your debt, which may include exploring options for re-negotiation and looking at other forms of liquidity
* control and cut costs, particularly in unstable economic environments, while avoiding actions that erode capital or undermine your business strategy.

Optimising capital when implementing the business plan may include:

* giving special consideration to all decisions regarding capital; do not use it wastefully
* developing operational efficiency strategies
* identifying areas of poor asset management and capital deployment
* using benchmarks to monitor your asset performance, both internally and externally (against competitors)
* putting plans in place so you can get more capital quickly if you need it.

 Resources

You can find out more information on working capital by accessing the article on [Capital: Definition, How It's Used, Structure, and Types in Business](https://www.investopedia.com/terms/c/capital.asp). This article will help to completely understand capital and how it can apply to your businesses structure and ways of working.

You can find out more information about capital funding strategies by accessing the article [20 Things All Entrepreneurs Should Know About Angel Investors](https://www.forbes.com/sites/allbusiness/2015/02/05/20-things-all-entrepreneurs-should-know-about-angel-investors/). This article will help you to understand the main things you need to understand when working with angel investors.

### Capital investment

Capital investment is different to that of your general everyday expenses, such as wages, stationery, electricity and other overheads.

Capital investment is concerned with the deployment of capital for long-term uses and refers to the essential investments by which your business provides the product or service to the customer. Capital investment is a good measure of the health of your business, its finances and the economy in general.

 Video

Review the video [Capital vs. operational expenses](https://www.linkedin.com/learning/certified-information-privacy-manager-cipm-cert-prep-1-privacy-program-development/capital-vs-operational-expenses?u=57684225) (LinkedIn Learning, 2:46 min), for an explanation of the differences between capital and operational expenses.

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**Video summary**

* **Definition and purpose** – Capital expenses (CapEx) are costs associated with acquiring and maintaining long-term assets, such as buildings and equipment, while operational expenses (OpEx) cover the day-to-day costs of running a business, like payroll and utilities.
* **Financial management** – CapEx and OpEx are different. Funds allocated to one type of cost typically cannot be used for the other and businesses often have specific guidelines or thresholds to differentiate between them.
* **Tax and reporting implications** – Capital and operational expenses are treated differently under tax laws and financial reporting regulations, making it important for businesses to accurately classify these expenses to ensure compliance and effective financial management.

#### ****Reasons for capital investment****

The reasons for capital investments include:

* purchasing additional capital assets to allow the business to expand
* capitalising on advancements in technology to increase the efficiency of the business, thereby reducing costs
* replacing existing assets that have reached the end of their utility, such as a high-mileage delivery van.

When identifying your business's capital investment requirements, you will have to consider every need and cost involved in each process so you can make an accurate calculation. Capital investment requirements may include:

* improving working conditions within a business to ensure their long-term safety
* changing, repairing or replacing equipment or machinery to reduce errors and maintain consistent output
* improving employee skills or upgrading machinery to develop product quality
* investing in packaging, shipping and infrastructure to meet customer needs and demands
* buying land and real estate for work sites, rather than leasing.

Each of these capital investment requirements may occur during a different operational period within the business. For instance, buying land or real estate might be a particular priority for you and capital investment for it would come near the beginning of your business.

On the other hand, you should not need to invest in upgrades or replacements for your equipment or machinery for a considerable amount of time. Other investments might be more ongoing, for instance, in the development of packaging, shipping and infrastructure. You therefore need to work out not only how much capital investment you will need but when you will need it.

 Video

Review the video [Capital budgeting overview](https://www.linkedin.com/learning/finance-foundations-2018/capital-budgeting-overview-23073220?resume=false&u=57684225) (LinkedIn Learning, 3:53 min) to learn more about exploring the importance of budgeting for capital items. This video highlights the importance of capital budgeting in small businesses and shows examples of how you can apply this process to your business.

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**Video summary**

* **Definition and importance – Capital budgeting involves making long-term asset purchase decisions, requiring significant cash outlays and is crucial for planning expected returns on investments, as mistakes can have lasting financial repercussions.**
* **Example analysis – In the case of Franklin Noodle Shop considering a $10,000 dumpling machine, the analysis includes cash inflows from reduced operating costs and increased production profits, leading to a projected net positive cash flow of $8,000 over 10 years.**
* **Time value of money – A critical factor in capital budgeting is the time value of money; considering the risk-adjusted cost of capital (16% in this case) reveals that the dumpling machine purchase would not be advisable, as alternative investments could yield higher returns.**

## **Set budget targets to track financial performance**

Establishing clear budget targets is essential for effectively tracking financial performance, enabling businesses to measure progress, identify variances and make informed decisions that drive sustainable growth.

### Key parts of a budget

A budget is an estimate of income and expenditure for a set period. Budgets are a useful tool to identify trends over time, such as whether cash flow is increasing or decreasing. For this reason, you need to closely monitor the achieved results and compare them to budget records. For example:

* Are they meeting your expectations or not?
* What are the reasons for this?

It is vital to have a conservative and realistic outlook when producing a budget. This means using data based on the most likely outcome. While this does not rule out good outcomes, it prepares the business for bad outcomes. If the budget is too optimistic, it will make the organisation look as though it has performed badly, even if that is not the case. The owner will then be forced to explain this, which may lessen confidence in the organisation.

On the other hand, a budget that is too easy to achieve can prevent organisational growth. Employees will not have to work hard to reach their targets which may affect their motivation to take initiative.

A budget needs to estimate expenditure levels based on data from previous years while also considering specific factors that will impact expenses, such as new products, larger shop space or a downturn in the market.

It is useful to get feedback on budgets from employees. They are knowledgeable about expenses and revenue in their area. You should also take on board any other input, such as relevant trade news or business developments.

It is important to remember that future expenses will likely deviate from past years' budgets and you need to adjust based on these deviations. For example, you may need to plan for maintenance work or marketing campaigns that were not required in the previous budget.

A completed budget should include:

* profit and loss summary
* budget assumptions
* summary of the marketing model
* key points on revenue and expense line items
* variances from the previous year or other periods.

Once a budget is completed and approved, it should be used straight away. All financial decisions should be made with reference to it.

**Case scenario example:**

At Bella's Bakery, the owner, Bella, recognises the importance of using her budget as a tool to identify financial trends over time. Each month, she meticulously monitors her cash flow, comparing actual results against her budgeted figures to know if they align with her expectations. Recently, she noticed a slight decline in sales during the typically busy holiday season, prompting her to investigate the reasons behind this trend.

Bella ensures her budget is conservative and realistic, basing it on historical data while factoring in potential new expenses, such as marketing campaigns for new product launches. She actively seeks feedback from her staff, who provide valuable insights into daily operations and customer preferences. This collaborative approach helps Bella adjust her budget as needed, preparing her for unforeseen challenges like rising ingredient costs or shifts in consumer demand.

With a completed budget that includes a profit and loss summary and key points on revenue and expenses, Bella uses it as a reference for all financial decisions. By staying vigilant and adaptable, she positions Bella's Bakery for sustained growth and success, ensuring that she can navigate both good and challenging times effectively.

Budgets help an organisation plan ahead and make decisions regarding future spending. They should be monitored during the timeframe for which they were produced to manage the amount of money the business is spending.

Budgets will need to be shared with a range of people in a business. These may include:

* financial investors
* franchise agency
* owner or operators
* partners.

 Resources

For more information on how to create a budget, you can access the Australian government’s [Create a budget](https://business.gov.au/finance/financial-tools-and-templates/create-a-budget). The webpage provides additional resources such as templates and tips on how to your business can effectively plan its income and spendings.

### Benefits of making a budget

Setting budget targets allows you to plan effectively for your business's financial future and to control your cash flow. You will create a financial action plan by basing your budget on your business plan.

There are several benefits of developing a business budget, including:

* effective money management
* appropriate allocation of resources
* more effective performance management
* improved ability to meet business objectives
* better decision-making
* the ability to identify problems before they occur (for example, cash flow difficulties)
* enhanced ability to plan for future risks.

Once you have created a budget, you should stick to it as far as is possible and reasonable. However, you should regularly revisit, review and revise it where appropriate. Some businesses have a rolling budget, so that they are continually budgeting for the upcoming 12 months.

**Case scenario example:**

Bella's Bakery, a small family-owned business, is preparing for its second year of operation by creating a comprehensive budget based on its business plan. Bella sets specific financial targets, aiming to increase monthly sales by 15%, expand her product line and save for a new oven. She allocates funds to key areas such as ingredients, labour, marketing and equipment, ensuring that each category reflects its importance to her overall strategy.

By regularly tracking actual expenses against her budgeted figures, Bella can make informed decisions and identify potential cash flow issues early on. To maintain flexibility, she adopts a rolling budget approach, revisiting and revising her budget quarterly based on current performance and market changes. This structured budgeting process enhances Bella's ability to manage money effectively, meet business objectives and plan for future growth, giving her confidence in navigating the challenges of running a successful bakery.

### How to create a budget

**Creating a budget involves the following 2 steps:**

1. **Identify your current income and expenditure. You will need to know your projected sales, the direct costs of sales and the fixed costs for the budget period you are looking at. These will tell you how much money the business is making and spending.**
2. **Work out the difference between your income and expenditure to know how much your business is making. You can review costs and work out ways to reduce them and you can check if you are likely to have cash flow problems at any point and make a plan to do something about them.**

**It is always a good idea to consult any staff in the business with financial responsibilities to provide you with estimates of figures for your budget. They may have a better idea than you do of production costs or specific project control, so compare your estimates against theirs for a more realistic budget. This involvement will also give them greater commitment to meeting the budget.**

**Initially, one overall operating budget should be sufficient to set out how much more is needed to run the business. However, as the business grows you may find that smaller individual budgets are more manageable, for instance a marketing or sales budget.**

### ****Budget types****

There are 2 types of budgets:

* **Fixed budgeting** – This type of budget relies on figures from the past that are adjusted to account for the future. It asks questions like, 'What did we do in the past?', 'What factors will cause a change?' and 'What will we do in the budget period?'
* **Flexible budgeting** – This type of budget allows for adjustments in volume or activity in revenue levels. This type of budgeting is designed to allow changes and adjustments to cost levels, so they match the level of activity actually attained. The budget is compared to actual expenses for control purposes.

 Video

Review the video [Make a budget that works](https://www.linkedin.com/learning/personal-finance-tips-and-tricks/make-a-budget-that-works?resume=false&u=57684225) (LinkedIn Learning, 3:10 min), to learn how to create a budget that is manageable for your circumstances.

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**Video summary**

* **Personalised approach** – **There is no one-size-fits-all budgeting solution; the most effective method is one that aligns with your personal habits and preferences, whether that involves using an app, spreadsheet or traditional methods like cash envelopes.**
* **Assess current spending** – **Begin by analysing your current financial situation through a month of tracking income and expenses without making immediate changes, allowing you to identify specific spending patterns and areas for improvement.**
* **Choose intuitive systems** – **Select a budgeting method that suits your learning style and is easy to maintain, ensuring it remains accessible and convenient; regular reviews and adjustments are essential for staying on track and achieving financial goals.**

### ****Using your budget to monitor performance****

Your budget can serve many useful purposes. It can indicate the costs and revenues linked to each of your activities and provide important information for management to inform their decision-making. Similarly, the budget can be a means of monitoring and controlling your business, particularly if you analyse the differences between your actual and budgeted income. The easiest way to monitor your financial performance is to constantly review your budget, including your revenue and expenses, against performance metrics. This will give you a clear indication of whether you are tracking as planned.

**Goal setting and planning**

One way to set tangible performance metrics is to plan detailed financial goals. You can use the SMART acronym to ensure your goals are clear and attainable and your progress is measurable.

**Specific** – The goal needs to be clearly defined, otherwise you will not be motivated to achieve it.

**Measurable** – You should be able to track to progress of your goal. This will help you to stay focused. For example, you can track how much expenses your business has reduced each month.

**Achievable** – Your goal needs to be realistic to be successful.

**Relevant** – Your goal should relate to your business goals and strategies. For example, your business may want to save up significant cash amounts to prepare for a large investment in machinery or a marketing campaign.

**Time-bound – Your goal needs to have a date or deadline to finish it.** For a budget, you can conduct a review on how well you’ve met your goals periodically. These reviews can be monthly, half-yearly or annual.

The more specific your goals are, the easier it is to ensure your business is making progress.

**Case scenario example:**

At Bella's Bakery, the owner, Bella, sets a specific goal to decrease her operating expenses by 10% over the next quarter to support her business goal of maximising net profits. In receiving a tangible goal that she can work towards; she can then start thinking about cost cutting approaches. She can review her current costs from a profit and loss statement (P&L) for any controllable cost increases such as reducing water and electricity wastage. She can consider Lastly, she can compare her results with last quarters expenses to ensure she is focusing on the right cost control strategy.

 Resources

Review the article [SMART Goals: How to Determine And Set Goals You Can Achieve](https://www.personatalent.com/business/how-to-set-acheivable-smart-goals/) to learn more about what SMART goals are, how they can be applied in your professional and personal life and how you can reach the goals you set.

 Video

Review the video [Goal setting](https://www.linkedin.com/learning/leading-yourself/goal-setting?resume=false&u=57684225) (LinkedIn Learning, 2:34 min) to learn how to set a SMART goal and keep it related to your business objectives.

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**Video summary**

* **Beyond SMART goals** – While SMART goals are specific and task-oriented, they can be limiting and uninspiring; instead, focus on setting strategic goals that are larger, more complex and aimed at significant personal or organisational growth.
* **Impact and engagement** – When establishing strategic goals, prioritise their impact on personal and organisational objectives and ensure you have a strong personal connection to the goal to maintain motivation and commitment.
* **Flexibility in progress** – You don’t need to have every detail figured out from the start; embrace the learning process and be open to adjusting your approach as you work toward achieving your goals.

### ****Key performance indicators****

Key performance indicators (KPIs) are quantifiable measures used to evaluate the success of meeting performance objectives.

To improve your business's performance, it is essential that you understand and keep track of the key drivers influencing and impacting your business. The 9 key businesses impacting most businesses are:

* sales
* costs
* working capital
* revenue
* sales growth
* costs
* profit
* cash flow
* accounts receivable.

Monitoring the figures related to these drivers and measuring them against your budgets and forecasts will allow you to detect any cash flow or profitability problems or falling profitability and help you identify what might be causing them.

Your KPI will vary depending on your business and the types of products or services you offer. However, here are some examples of effective KPIs that use the SMART principles:

* Respond to customer queries within 24 hours of receiving them.
* Fulfil customer orders within 24 hours of receiving them.
* Reach a sales target of $5,000 every month.
* Produce 650 units each month.

 Video

Review the video [Identifying key performance indicators](https://www.linkedin.com/learning/chief-technology-officer-career-guide/identifying-key-performance-indicators?resume=false&u=57684225) (LinkedIn Learning, 3:35 min) for a more detailed explanation of key performance indicators and how they are used in measuring performance.

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**Video summary**

* **Definition and purpose of KPIs –** Key performance indicators (KPIs) are measurable metrics that help assess the effectiveness and success of applications in achieving specific business objectives, such as increasing subscriptions or revenue.
* **Strategic planning –** When identifying KPIs, start with broad business goals and then drill down into specific user behaviours and app usage patterns, ensuring that the selected metrics are actionable and relevant to your objectives.
* **Focus on core metrics –** Limit the number of KPIs to around 5 to 10 key indicators that align with organisational goals; these should be regularly reviewed and adjusted as objectives evolve, providing a precise measure of success for technology initiatives.

## **Monitor financial performance using systems**

Monitoring financial activities involves producing reports to document progress and identify financial outcomes. These reports are summaries of financial information and are used to communicate with managers or owners. It is important they have up-to-date information so stakeholders can make reasonable decisions during business.

This reporting involves financial performance targets, the results of which are assessed and analysed. The analysis process allows you to examine the resulting figures and their circumstances to determine the influences that may have affected the performance and the context in which the business has been conducted. By examining the relevant facts and information, you can identify whether goals are being met.

Reports need to separate out financial elements clearly, so data is easy to read and interpret. Along with text, figures need to be associated with the correct text label or information and be logically sequenced. Different financial aspects need to be recognisable and any terminology referenced or fully explained. You can use a combination of text and graphics to present information more clearly. For example, using tables with defined rows and columns can help you communicate complex information, such as product sales. This helps prevent others from misreading data or confusing figures and their origins. Alternatively, you may want to colour-code information to make it more easily identifiable.

Strategies you can use to convey information in reports clearly include:

* using space to separate different aspects and to break up complex information
* spreading information out and not overfilling the page (remember to define the information that belongs together using headings and subheadings)
* having a simple layout that is consistent throughout such as aligning text to the right and using borders around graphs
* choosing a font style and size that is easy to read, including using a different size for headings and body text
* using graphs to show financial data
* using tables and charts to present complex information
* having a contents table that details the main sections of the report
* separating information into different sections
* providing an introduction or report summary to explain the purpose of the report.

### Digital technologies

Producing reports involves collating and presenting information in a variety of ways. To do this easily, you will need to use electronic technologies, including hardware and software. Hardware relates to the computer or device, while the software is the application or program on the computer or device with which you create your report. The following table lists common hardware technologies for financial reporting.

Table 39: Hardware technologies

|  |  |
| --- | --- |
| Hardware | Description of use |
| Computers (desktops or laptops) | Essential for running financial software applications, performing calculations and creating reports |
| Tablets | Used for accessing financial data and reports on-the-go, allowing for flexibility in managing finances |
| Printers | Necessary for producing hard copies of financial reports and statements for distribution or record-keeping |

The following table lists common software applications for financial reporting.

Table 40: Software technologies

|  |  |
| --- | --- |
| Hardware | Description of use |
| Microsoft Excel | A versatile spreadsheet tool used for performing calculations, creating financial models and generating reports. Ideal for data analysis and visualisation through charts and graphs. |
| MYOB or Xero | These are cloud-based accounting software systems that allow real-time financial reporting, expense management and invoicing. They facilitate collaboration with accountants and their system integrates with various applications. |

### Excel in finance

Microsoft Excel is a powerful tool for performing calculations, assessing comparative spend against budget and producing meaningful reports for relevant people. It is part of the Microsoft Office suite and has the endless capability to do all you need and perhaps more in your financial management role.

 Video

Review the video [How to Track Your Sales Using Excel in Under 5 Minutes 2024](https://www.youtube.com/watch?v=-vW-Q-Oyyts) (YouTube, 2:24 min) for more understanding of how you can use Excel to manage your finances.

**Video summary**

* Learn to use the Export Emails to Excel, Comma-Separated Values (CSV) or Google Sheets Chrome extension to automatically transfer specific information from email bodies into a Google Sheet, ensuring real-time updates as new emails arrive.
* By creating a Gmail label for order confirmation emails, you can extract and customise data columns (such as order number, product, price and dates) into an organised spreadsheet for streamlined order management.
* This method provides a shared, auto-updating record of orders that allows teams to monitor revenue, sales trends and processing times efficiently using Google Sheets.

### Xero and MYOB in finance

Both MYOB and Xero are leading accounting software solutions that cater to the needs of small to medium-sized businesses. They offer a range of features designed to streamline financial management, enhance reporting capabilities and improve overall business efficiency. This software can help enable automated reporting and even expedite your tax reporting obligations.

 Video

Review the video [How to Create Financial Reports in Xero (P&L, Balance Sheet)](https://www.youtube.com/watch?v=Fu4fcwcIGLg) (YouTube, 4:48 min) for more information on how you can create your own financial reports in Xero.

**Video summary**

* Learn to generate financial reports by logging into Xero, navigating to the ‘Accounting tab’ and selecting ‘Reports’. Key reports like the balance sheet and profit & loss (P&L) can be customised by setting specific dates or comparing data across different periods.
* The balance sheet report allows users to select custom date ranges, view assets, liabilities and equity and compare financial data across months or years to track performance and trends.
* The profit & loss report provides insights into income, operating expenses, cost of goods sold and net income. Users can compare data across quarters or years and customise the time periods for detailed analysis.

## Evaluate how marketing and operations impact finances

Cost control and return on investment (ROI) analysis are essential financial management tools that help businesses, particularly entrepreneurs, evaluate the efficiency of their investments, such as marketing and operations activities, to manage expenses effectively. ROI analysis is a financial metric used to evaluate the profitability of an investment relative to its cost. It helps entrepreneurs assess whether an investment is worthwhile by providing a clear measure of returns.

### Methods of cost control

Managing costs effectively is crucial to sustain and grow a business. Implementing robust cost control methods can help you optimise your resources, improve profitability and ensure that you are prepared for unexpected expenses.

Common cost control methods can include:

* proper budget planning
* monitoring expenses with checkpoints
* change control systems
* time management
* tracking earned value (Indeed Editorial Team, 2024).

#### Proper budget planning

Proper budget planning is the foundation of effective cost control. It involves creating a detailed budget that considers all aspects of a project, including labour, materials and potential unexpected costs. This ensures that entrepreneurs have a clear financial roadmap to follow.

For example, a new café owner plans to open their business and estimates the costs involved, including renovations, equipment, initial inventory and employee wages. By allocating funds for unexpected expenses, such as additional repairs or delays in equipment delivery, the owner can avoid financial strain and ensure the café opens on schedule without overspending.

#### Monitoring expenses with checkpoints

Monitoring expenses through checkpoints involves regularly reviewing project costs against the budget. This method allows entrepreneurs to identify discrepancies early and make necessary adjustments to stay on track.

For example, a small marketing agency launches a digital advertising campaign with a budget of $10,000. The agency sets weekly checkpoints to review spending and campaign performance. If ad spending exceeds expectations, the agency can adjust its strategy or reallocate funds to more effective channels before the budget is depleted.

#### Change control systems

Change control systems are structured processes used to manage and document any alterations made to a project that could significantly impact the budget, timeline or scope.

These systems ensure that all changes are carefully evaluated, approved and recorded to maintain project integrity and financial performance.

This method ensures that all changes are documented and necessary adjustments to the budget are made accordingly.

For example, a local construction firm is working on a residential project when the homeowner requests additional features not included in the original plan. The firm implements a change control system to assess the impact of these changes on labour and material costs. By documenting these changes and adjusting the budget accordingly, they can maintain profitability while meeting client expectations.

#### Time management

Effective time management is crucial for keeping project expenses down. Delays can lead to increased costs due to extended use of resources and labour.

For example, an event planner organises a proposal event for a couple with a strict timeline. By creating a detailed schedule with milestones leading up to the event, the planner ensures that all tasks are completed on time. If any tasks fall behind schedule, they can quickly address them to prevent additional costs associated with last-minute arrangements or overtime pay.

#### Tracking earned value

Tracking earned value involves measuring project performance by comparing the planned progress against actual progress and costs incurred. This method helps predict future financial outcomes based on current performance.

For example, a software development start-up is working on a new application with a budget of $50,000 and an expected completion time of 6 months. After 3 months, they calculate that 60% of the work is completed but at 70% of the budgeted cost. By tracking earned value, they can assess whether they are on track to complete within budget and make informed decisions about resource allocation for the remaining development phase.

### Return on investment

Return on investment (ROI) analysis is a financial metric used to evaluate the profitability of an investment relative to its cost. It helps entrepreneurs assess whether an investment is worthwhile by providing a clear measure of returns.

You can calculate ROI using the following formula:

* **Net profit** is the total revenue generated from the investment minus the total costs associated with it (Total revenue – Total investment).
* **Total investment** includes all costs incurred in making the investment.

For new entrepreneurs, leveraging ROI in marketing is not just about measuring success, it’s about making strategic decisions that drive growth and efficiency.

By understanding and applying ROI principles, they can optimise their marketing efforts, manage budgets effectively and ultimately build a successful business foundation (Vipond, n.d.).

An example of calculating the ROI:

**Business**: An online boutique selling handmade accessories

**Investment**: The entrepreneur decides to invest in a targeted social media advertising campaign to increase sales during the holiday season.

**Total investment**: $5,000

**Expected revenue**: Based on previous campaigns and market research, the entrepreneur expects the campaign to generate additional revenue of $15,000.

To find the net profit generated from the investment, we use the following formula:

Net profit = Total revenue – Total investment

Plugging in the numbers:

Net profit: $15,000 – $5,000 = $10,000

ROI: ($10,000 ÷ $5,000) x 100 = 200%

Based on this example, an ROI outcome of 200% means that for every dollar invested in the advertising campaign, the entrepreneur earned $2 in return.

## Assess financial ratios against industry benchmarks

Financial ratios are essential tools for evaluating a company's performance by comparing its financial metrics against industry standards or benchmarks. This practice, known as benchmark ratio analysis, helps businesses identify their strengths, weaknesses and areas for improvement relative to peers within the same industry.

They provide insights into different aspects of a business's operations, including profitability, liquidity, efficiency and leverage. Ratios are a quicker way of understanding a business’s financial health rather than analysing individual financial statements.

While most of these financial ratios only apply to publicly listed companies to access this information, they can be a starting point for comparing similar businesses in your sector to understand your position in terms of industry standards.

There are 4 key categories of financial ratios to understand:

1. profitability ratios
2. liquidity ratios
3. operating efficiency ratios
4. leverage ratios.

While some of these ratios have been touched on in Lesson 1, this section will summarise all of the different ratios you may use for your business to benchmark against industry averages.

#### Profitability ratios

Profitability ratios measure a business's ability to generate profit relative to its revenue, assets or revenue and equity. They are essential for evaluating overall performance and financial health.

The common profitability ratios include:

* gross profit margin
* net profit margin
* return on assets (ROA)
* return on equity (ROE).

**Gross profit margin**

The gross profit margin compares gross profit to total revenue, indicating how efficiently a business converts sales into profits after covering the cost of goods sold.

It can be calculated through this formula:

In general, it is better to have a large gross profit margin (GPM). A higher GPM indicates that a business is more efficient in managing its production costs relative to its sales revenue.

For example, Company A:

Revenue: $1,000,000

COGS: $400,000

Gross profit: $1,000,000 – $400,000 = $600,000

Gross profit margin: ($600,000 ÷ $1,000,000) x 100 = 60%

In this example, Company A has a GPM of 60%, meaning it retains $0.60 of every dollar in revenue after covering the costs of goods sold.

**Net profit margin**

The net profit margin ratio measures net profit as a percentage of total revenue, providing insights into overall profitability after all expenses are accounted for.

It can be calculated through the given formula:

A higher net profit margin is preferred and reflects effective cost management and pricing strategies, leading to greater profitability.

For example, Company C:

Net profit: $250,000

Total revenue = $1,000,000

Net profit margin: ($250,000 ÷ $1,000,000) x 100 = 25%

A net profit margin of 25% means that for every dollar of revenue generated by Company C, it retains $0.25 as profit after all expenses.

**Return on assets (ROA)**

ROA measures how effectively a company uses its assets to generate profit. It provides insight into management efficiency in utilising assets to produce earnings.

It can be calculated through the given formula:

A higher outcome is better as it indicates a more effective use of assets to generate profits.

For example, Company E:

Net income: $50,000

Total assets = $1,000,000

ROA: ($50,000 ÷ $1,000,000) x 100 = 5%

In this example, an ROA of 5% means that for every dollar of assets owned by the company, it generates $.05 in profit.

**Return on equity (ROE)**

ROE measures the return generated on shareholders' equity. It indicates how effectively a company uses equity financing to generate profits.

It can be calculated through the given formula:

A higher outcome is better as it signifies greater efficiency in generating returns for shareholders.

For example, Company F:

Net income = $50,000

Shareholders' equity = $250,000

ROE: ($50,000 ÷ $250,000) x 100 = 20%

An ROE of 20% means that for every dollar invested by shareholders in equity, the company generates $0.20 in profit.

##### Liquidity ratios

Liquidity ratios are financial metrics that measure a business's ability to meet its short-term obligations (within 12 months) using its most liquid assets.

Common liquidity ratios can include:

* current ratio
* quick ratio.

**Current ratio**

The current ratio compares a company’s current assets to its current liabilities. It assesses the ability to pay off short-term debts with short-term assets.

It can be calculated through the given formula:

Higher the ratio is generally better, ideally between 1.5 and 2. A ratio below 1 indicates potential liquidity issues.

For example, Company G:

Current assets = $500,000

Current liabilities = $250,000

Current ratio: ($500,000 ÷ $250,000) = 2.0

A current ratio of 2.0 means that the company has $2 in current assets for every $1 in current liabilities. This indicates strong liquidity and suggests that the company can comfortably meet its short-term obligations.

**Quick ratio**

The quick ratio measures a company’s ability to meet its short-term obligations without relying on inventory sales. It focuses on the most liquid assets.

It can be calculated through the given formula:

The higher the current ratio the better, with an aimed target above 1. A ratio below 1 may indicate potential liquidity challenges.

For example, Company H:

Current assets = $260,000

Inventories = $10,000

Current liabilities = $130,000

Quick ratio: (260,000 – 10,000) ÷ 130,000 = 1.92

A quick ratio of approximately 1.92 indicates that Company H can cover its current liabilities nearly twice over without relying on inventory sales.

##### Operating efficiency ratios

Operating efficiency ratios are financial metrics used to evaluate how effectively a business manages its operational expenses in relation to its revenue.

Common operating efficiency ratios can include:

* accounts receivable days
* accounts payable days
* stock turnover.

**Accounts receivable days**

This measures how quickly a business collects cash from its credit sales.

It can be calculated through the given formula:

The lower this number is, the better, as it indicates efficient collection of receivables, which improves cash flow.

For example, Company I:

Accounts receivable = $80,000

Total credit sales = $600,000

Accounts receivable days = (80,000/600,000) x 365 = 48.67

An accounts receivable days figure of approximately 48.67 days means that it takes the company nearly 49 days to collect payment from customers after a sale is made.

**Accounts payable days**

This measures how quickly a business pays its suppliers. This ratio reflects the company's payment practices and cash management strategies.

It can be calculated through the given formula:

The lower the number of days is generally better, but it depends on supplier agreements and industry norms. A very high number may indicate potential issues with cash flow or supplier relationships.

For example, Company J:

Accounts payable = $50,000

Total purchases on account = $300,000

Accounts payable days = ($50,000 ÷ $300,000) x 365 = 60.83

An accounts payable days figure of approximately 60.83 days suggests that the company takes about 61 days to pay its suppliers.

**Stock turnover**

This measures how many times inventory is sold and replaced over a period. This ratio indicates the efficiency of inventory management and sales performance.

It can be calculated through the given formula:

A higher figure is better, as it indicates efficient inventory management and strong sales performance. However, an excessively high turnover may suggest insufficient inventory levels that could lead to stockouts.

For example, Company K:

Cost of goods sold (COGS) = $500,000

Average inventory = $100,000

Stock turnover = 500,000 ÷ 100,000 = 5 times

A stock turnover ratio of 5 means that the company sells and replaces its inventory 5 times during the period assessed. This is generally considered good for most industries, indicating efficient inventory management and strong sales performance.

##### Leverage ratios

Leverage ratios are financial metrics that assess the extent to which a business uses debt to finance its operations and assets. These ratios provide insights into a business’s financial structure, indicating how much of its capital comes from debt compared to equity.

Common leverage ratios include:

* debt ratio
* interest coverage ratio
* debt to equity ratio.

**Debt ratio**

The debt ratio measures the proportion of a business’s total assets that are financed by debt. It provides insight into the overall level of indebtedness.

It can be calculated through the given formula:

A lower ratio is generally better, as it indicates lower financial risk; however, acceptable levels can vary by industry.

For example, Company L:

Total liabilities = $300,000

Total assets = $800,000

Debt ratio = 300,000 ÷ 800,000 = 0.375

A debt ratio of 0.375 means that 37.5% of the company’s assets are financed through debt.

**Interest coverage ratio**

The interest coverage ratio measures how easily a company can pay interest on its outstanding debts using its earnings before interest and taxes (EBIT). It indicates the company's ability to meet interest obligations.

It can be calculated through the given formula:

The higher the ratio, the better, as it reflects lower financial risk and greater capacity to cover interest payments.

For example, Company M:

EBIT = $120,000

Interest expenses = $30,000.

Interest coverage ratio = 120,000 ÷ 30,000 = 4

An interest coverage ratio of 4 means that the company earns 4 times its interest expenses before taxes and interest are deducted.

**Debt to equity ratio**

This ratio compares a company’s total liabilities to its shareholders' equity, showing how much debt is used to finance the business relative to equity.

It can be calculated through the given formula:

The lower the ratio is generally better, as it indicates less financial risk; however, some industries may operate effectively with higher ratios.

For example, Company N:

Total liabilities = $300,000

Shareholders' equity = $700,000.

Debt to equity ratio = 300,000 ÷ 700,000 = 0.43

A debt-to-equity ratio of approximately 0.43 indicates that for every dollar of equity, the company has $0.43 in debt. This suggests a moderate reliance on debt financing, which can be considered healthy depending on the industry (Queensland Government, n.d.).

##### Cash flow ratios

Cash flow ratios evaluate the liquidity of a business with regard to their use of cash. They evaluate how much cash a business can use to protect itself from short-term cash falls and any unexpected financial obligations. Cash flow ratios are especially important for businesses whose cash flows greatly vary from their reported profit.

**Operating cash flow ratio**

Operating cash flow ratio evaluates if the business has sufficient cash it can pay out quickly for its short-term liabilities, including any debts, loan payments, bills and other expenses.

Operating cash flow ratio can be calculated with the following formula:

**A higher cash flow ratio is generally better as it indicates a business has enough cash to pay off its short-term obligations. However, a lower cash flow ratio is not necessarily indicative of impending failure. For instance, a business could invest in a new product line or scale the size of its operations, which would cause a significant decline in cash in the shortfall. As with all ratios, it is important to examine them together and consider their context.**

For example, Company O:

Total operating cash flow = $500,000

Total current liabilities = $80,000

Operating cash flow ratio = 200,000 ÷ 80,000 = 2.5

**A 2.5:1 ratio suggests that the business has enough cash to meet its short-term liabilities with its operating cash flow and thus suggests good financial stability.**

**Cash flow to net income ratio**

Cash flow to net income ratio evaluates how well a business converts its net income into cash flow. Cash flow to net income ratio can be calculated using this formula:

For example, Company P:

Total operating cash flow = $100,000

Net income = $40,000

Operating cash flow ratio = 100,000 ÷ 40,000 = 2.5

This means that Company P has 2.5 times more operating cash flow compared to net income.

**Cash flow vs liquidity ratios**

Cash flow and liquidity ratios both measure a business’s liquidity in meeting its financial obligations. However, cash flow ratios evaluate a business’s liquidity on cash terms whereas liquidity ratios use assets and liabilities. For product-based businesses, inventory can sometimes misleadingly inflate a business’s current ratio performance.

When a business struggles to make sales, its inventory value will increase on the balance sheet. Since inventory is part of current assets, an increase in inventory will raise the total current assets, thereby inflating the current ratio if current liabilities remain unchanged. In such cases, liquidity ratios may not as accurately reflect the business’s actual ability to meet short-term liabilities during a crisis compared to cash flow ratios.

 Practice activity

### Activity 11: Financial ratios for EcoGlow Pty Ltd

Review the scenario and answer the 3 questions.

**Activity scenario**:

After 6 months of business operation, EcoGlow Pty Ltd wants to assess its liquidity to measure how secure and efficient it is in paying off its short-term debts and expenses. Here is an informal summary of some relevant financial information:

Table 41: EcoGlow Pty Ltd financial summary

|  |  |
| --- | --- |
| Item | Amount |
| EcoGlow Pty Ltd total current assets | $12,000 |
| EcoGlow Pty Ltd total current liabilities | $8,000 |
| EcoGlow Pty Ltd accounts receivable days | 38 days |
| Industry benchmark for accounts receivable days | 30 days |

1. Calculate EcoGlow Pty Ltd’s current ratio using the following formula. Indicate your answer rounded to the nearest 1 decimal place.

Current ratio = Total current assets ÷ Total current liabilities

1. The candle industry’s benchmark for liquidity is a current ratio of 2:1. Is EcoGlow Pty Ltd above or below the benchmark?
2. Which 2 are the reasons why EcoGlow Pty Ltd has a current ratio that is lower than the industry standard?

Table 42: Multiple choice

|  |  |  |
| --- | --- | --- |
| # | Choices | Answers |
|  | EcoGlow Pty Ltd may be more volatile with its financial position as it is a new business. |  |
|  | EcoGlow Pty Ltd has too much short-term and long-term debt. |  |
|  | EcoGlow Pty Ltd is taking longer than industry standard to collect customer payments. |  |
|  | EcoGlow Pty Ltd does not have enough investors funding it. |  |

## Adopt new technologies to improve profits

Technology is used in many businesses to improve output and efficiency. Technology can speed up processes and improve the quality of work. Technology may also reduce a business's need for staff or enable the expansion of production without needing to hire additional staff. With the right training and experience, technologies are a bonus to the workplace.

From time to time, it will be necessary to keep informed about any new and emerging technologies that can help improve your business output. You should take the time to research these from existing technology suppliers and experts or from within your business industry.

Researching opportunities include:

* attending trade events and shows
* attending business seminars relating to improvements and technologies
* reviewing journals and industry news to identify business developments and opportunities
* networking with other businesses and associations to identify how technologies are being used
* speaking with technology experts to determine what may be appropriate for your business.

New and emerging technologies are developed to improve energy efficiencies, make work processes easier and quicker and reduce the costs of producing or production goods.

Technologies that take less time and energy will help improve your running costs. This can give your business an edge over your competitors as quality and production increase. However, it should be noted that new technologies can be costly to install and implement and a budget will need to be set aside to pay for these expenditures. You may also need to factor in costs for training, new maintenance and servicing.

### Improve profitability through technology

To enhance profitability, small businesses in Australia can leverage various software solutions, including:

* Xero
* MYOB
* Microsoft Copilot.

These tools provide essential features that streamline financial management, automate processes and offer valuable insights.

#### Xero

Xero is a cloud-based accounting software designed specifically for small businesses. It provides a user-friendly interface and a suite of features that simplify financial management.

By implementing Xero, you can help increase your business profitability through:

1. Automating routine tasks such as invoicing and reconciliation allows business owners to focus on strategic initiatives rather than administrative duties.
2. Having access to real-time data helps businesses make timely decisions regarding budgeting and spending, ultimately leading to better financial health.
3. Streamlining invoicing and payment processes, Xero helps businesses maintain healthy cash flow, which is crucial for sustaining operations and funding growth initiatives.

For example, a freelance graphic designer, Sarah, manages multiple clients and projects simultaneously. She often struggles with invoicing and tracking payments, which leads to delays in cash flow. To improve her financial management, Sarah decides to implement Xero.

Sarah sets up automated reminders in Xero for clients with overdue invoices. If a client hasn’t paid by the due date, Xero sends a polite reminder email.

This feature decreases the likelihood of late payments, ensuring that Sarah maintains a steady cash flow. As a result, she can manage her expenses more effectively and invest in new projects without financial strain.

Xero also offers a premium subscription that integrates AI to help predict your future cash flow as a predictor to help manage and plan your finances.

#### MYOB

Similar to Xero, MYOB is another popular accounting software option for Australian small businesses, offering a range of features tailored to various business needs.

By implementing MYOB, you can help increase your business profitability through:

1. Automating payroll and inventory management, MYOB reduces administrative burdens, allowing businesses to allocate resources more effectively towards profit-generating activities.
2. Creating customisable reports provides insights into profitability trends, enabling business owners to make data-driven decisions that enhance financial performance.
3. Using expense tracking capabilities to help identify unnecessary expenditures and implement cost-saving measures.

For example, John runs a small retail store that sells home goods. He faces challenges with inventory management and payroll processing, leading to inefficiencies and increased costs. To address these issues, John decides to implement MYOB.

John uses MYOB to track inventory levels in real-time. The software alerts him when stock levels of popular items fall below a predefined threshold and generates purchase orders automatically.

By managing inventory efficiently, John avoids stockouts that could lead to lost sales.

#### Microsoft Copilot

Microsoft Copilot is an AI-powered tool integrated into Microsoft 365 applications that enhances productivity across various business functions.

By implementing Microsoft Copilot, you can help increase your business profitability through:

1. Automating basic tasks, Copilot allows owners to focus on higher-value work that directly contributes to profitability.
2. Providing access to real-time insights and data analysis capabilities, businesses can make informed decisions quickly. This agility can lead to better resource allocation and improved operational efficiency.

For example, Emma runs a small marketing agency that handles multiple clients' campaigns. Her team often spends too much time on repetitive tasks and data analysis instead of focusing on creative strategies. To enhance productivity, Emma decides to integrate Microsoft Copilot into their workflow.

Emma’s team uses Microsoft Copilot within Outlook to automate follow-up emails for client meetings. After each meeting, Copilot drafts a summary email highlighting key discussion points and next steps.

By automating these follow-ups, Emma’s team saves significant time each week that can be redirected towards developing innovative marketing strategies for their clients.

 Self-check

### How did you go?

You have completed the lesson: **Manage finances**. Check the boxes for the tasks you feel confident you can complete.

I can communicate financial information to others.

I can identify needs for non-current assets.

I can identify capital investment needs.

I can set budget targets to track financial performance.

I can monitor financial performance using systems.

I can evaluate how marketing and operations impact finances.

I assess financial ratios against industry benchmarks.

I adopt new technologies to improve profits.

# Answers and feedback

## Lesson 1

Activity 1: Charge-out rate for Perfect Snaps

1. Calculate Anna’s total billable time for the year in hours.

1,485 hours

Calculation: 1,980 x 0.75 = 1,485

1. Calculate Perfect Snap’s total labour gross profit margin for the year.

$15,000

Calculation: $20,000 – $5,000 = $15,000

1. Calculate the minimum charge-out rate for Anna. Round your answer to the nearest 2 decimal places.

$53.87 per hour

($65,000+$15,000) ÷ 1,485 = $53.87

Activity 2: Unit price for Gourmet Coffee Pty Ltd

1. Calculate the cost per unit for each coffee.

$5 per cup   
Calculation: ($15,000 ÷ $3,000) = $5

1. Calculate the selling price per unit for each coffee. Round your answer to 1 decimal place.

$6.5 per cup

Calculation: 5 + (5 x 0.3) = $6.5

Activity 3: Break-even analysis for Gourmet Coffee Pty Ltd

1. Calculate the total fixed costs per month.

$14,000

Calculation: $1,000 + $8,000 + $5,000 = $14,000

1. Calculate the total variable costs for one unit of coffee.

$6

Calculation: 0.5 + 3 = $3.5

1. Calculate the break-even point in units that Gourmet Coffee needs to achieve per month. Round up your answer to the nearest whole number.

4,667 cups per month

Calculation: $14,000 ÷ (6.5 – 3.5) = 4,667

Activity 4: Setting a pricing strategy

1. What was the suggested pricing strategy for your business and why? Your answer should be between 50 and 100 words.

Answers may vary but can include:

For a small business selling pre-made cheese boards, value-based pricing is often the most popular and effective strategy. Here's why:

**Perceived value** – Cheese boards are often perceived as premium, artisanal products. By pricing based on the perceived value, you can charge more for high-quality ingredients, unique combinations and beautiful presentations.

**Customisation** – Many customers are willing to pay extra for customised or themed cheese boards tailored to their specific events or preferences. This allows you to set higher prices for bespoke offerings.

**Market differentiation** – Value-based pricing helps differentiate your products from mass-produced alternatives. Customers looking for a special, gourmet experience are often less price-sensitive and more focused on quality and presentation.

**Flexibility** – This strategy allows you to adjust prices based on the occasion, such as higher prices for holiday-themed boards or special event packages.

While value-based pricing is popular, it's also beneficial to consider cost-plus pricing to ensure all your costs are covered and you maintain a healthy profit margin. Combining these strategies can help you balance profitability with customer satisfaction.

Activity 5: Gourmet Coffee Pty Ltd’s profit and loss statement

1. What is the net profit after tax for the financial period?

Table 43: Multiple choice

|  |  |  |
| --- | --- | --- |
| # | Choices | Answer |
|  | A profit gain of $12,500 |  |
|  | A profit gain of $1,875 |  |
|  | A profit loss of $12,500 |  |
|  | A profit loss of $1,875 |  |

1. What is a possible reason that Gourmet Coffee Co. has a much lower net profit after tax (NPAT) compared to gross profit?

Table 44: Multiple choice

|  |  |  |
| --- | --- | --- |
| # | Choices | Answer |
|  | Gourmet Coffee Co was taxed too much which pushed net profit down. |  |
|  | Gourmet Coffee Co generated too little sales and too little gross profit. |  |
|  | The cost of rent contributed to an excess of expenses that the gross profit needed to cover, which lowered its net profit. |  |
|  | Gourmet Coffee Co spends too much on maintaining its machinery and cost of goods sold, which lowered both its gross profit and net profit. |  |

Activity 6: Projected profit and loss statement for EcoGlow Pty Ltd

1. What are 3 relevant assumptions that EcoGlow Pty Ltd made in their projections?

Table 45: Multiple choice

|  |  |  |
| --- | --- | --- |
| # | Choices | Answers |
|  | Seasonal increase in motor vehicle expenses and advertising fees to cater to holiday sale fluctuations. |  |
|  | An increase in overall income tax. |  |
|  | An increase in sales revenue for holiday sales and a decrease in sales during hotter seasonal months. |  |
|  | An increase in all income and expenses due to inflation which the business adjusts for at the start of January 2025. |  |

1. Why was there a significant drop in profit from July 2025 to October 2025?

Table 46: Multiple choice

|  |  |  |
| --- | --- | --- |
| # | Choices | Answer |
|  | The business expects an increase in operating expenses due to inflation. |  |
|  | The business expects an adjustment in inflation to increase all its expenses which will decrease its net profit overall. |  |
|  | The business expects a drop in sales demand during warmer seasonal months which would decrease its gross profit. However, expenses remain static which the business has to pay for. |  |
|  | The business expects a high increase in cost of goods sold due to increased sales demand. |  |

Activity 7: Financial statement purposes

Match the financial statement to its correct purpose. Indicate the correct letter in the answer column.

Table 47: Matching

|  |  |  |
| --- | --- | --- |
| Purpose | Answer | Financial statements |
| Shows the inflow and outflow of cash over a specific period | C | 1. Profit and loss |
| Provides a summary of revenues and expenses over a specific period | A | 1. Balance sheet |
| Displays the company’s assets, liabilities and equity at a specific date | B | 1. Cash flow statement |
| An analysis that determines the point at which total revenues equal total costs | E | 1. Budget |
| Statements that forecast a business’s expected income, expenses and cash flow over a specified period | D | 1. Break-even analysis |

Activity 8: EcoGlow Pty Ltd cash flow projection

1. What is the net cash flow balance for December 2026?

Table 48: Multiple choice

|  |  |  |
| --- | --- | --- |
| # | Choices | Answer |
|  | A positive net cash balance of $25,000 |  |
|  | A positive net cash balance of $101,000 |  |
|  | A negative cash balance of $25,000 |  |
|  | A negative cash balance of $101,000 |  |

1. What does the projected net cash flow balance for December 2026 mean?

Table 49: Multiple choice

|  |  |  |
| --- | --- | --- |
| # | Choices | Answer |
|  | EcoGlow Pty Ltd estimates that it will gain a net cash of $25,000 for the month of December 2026. |  |
|  | EcoGlow Pty Ltd estimates that it will gain a net cash of $101,000 for the month of December 2026. |  |
|  | EcoGlow Pty Ltd estimates that it will lose a net cash of $25,000 for the month of December 2026. |  |
|  | EcoGlow Pty Ltd estimates that it will lose a net cash of $101,000 for the month of December 2026. |  |

1. Why is it important for EcoGlow Pty Ltd to create a cash flow projection?

Table 50: Multiple choice

|  |  |  |
| --- | --- | --- |
| # | Choices | Answers |
|  | It helps EcoGlow Pty Ltd estimate if they have enough cash to cover growth opportunities and future debts for the financial year ahead. |  |
|  | It shows how profitable EcoGlow Pty Ltd is for the next year. |  |
|  | It helps EcoGlow Pty Ltd estimate how much cash they have if they sell off unnecessary assets. |  |
|  | It helps EcoGlow Pty Ltd estimate how much revenue and expenses they will have for the financial year ahead. |  |

1. Why is the closing cash balance for December 2026 equal to the opening balance for January 2027?

Table 51: Multiple choice

|  |  |  |
| --- | --- | --- |
| # | Choices | Answers |
|  | The closing balance and opening balance are the same by coincidence as they do not relate to one another. |  |
|  | The closing balance for December 2026 shows how much cash EcoGlow Pty Ltd has up to that point. It then becomes the opening cash balance for the next month. |  |
|  | EcoGlow Pty Ltd had the same amount of cash sales for both months which resulted in identical cash balances. This is because they have the same clients each month ensuring they always have the same cash sales. |  |

Activity 9: Debt or equity finance

Review the statements carefully and indicate **Debt** or **Equity**.

Table 52: Debt or equity finance

|  |  |
| --- | --- |
| Finance type | Debt or equity |
| 1. Business credit card | Debt |
| 1. Overdraft | Debt |
| 1. Bank loan | Debt |
| 1. Crowdfunding | Equity |
| 1. Selling shares | Equity |
| 1. Cash from the owner or family or friends | Equity |
| 1. Personal loan | Debt |

## Lesson 2

Activity 10: Assets and cash flows

Review the following questions and select the correct answers.

1. Which 2 assets are considered as non-current assets?

Table 53: Multiple choice

|  |  |  |
| --- | --- | --- |
| # | Choices | Answers |
|  | Factory |  |
|  | Motor vehicle |  |
|  | Inventory |  |
|  | Cash on hand |  |

1. What is the projected cash flow forecast for the start of February if a business expects:

Table 54: Multiple choice

|  |  |  |
| --- | --- | --- |
| # | Choices | Answers |
|  | $5,000 |  |
|  | $8,000 |  |
|  | $4,000 |  |
|  | $8,500 |  |

Activity 11: Financial ratios for EcoGlow Pty Ltd

1. Calculate EcoGlow Pty Ltd’s current ratio using the following formula. Indicate your answer rounded to the nearest 1 decimal place.

1.5

Calculation: 12,000 ÷ 8,000 = 1.5

1. The candle industry’s benchmark for liquidity is a current ratio of 2:1. Is EcoGlow Pty Ltd above or below the benchmark?

Below

1. Which 2 are the reasons why EcoGlow Pty Ltd has a current ratio that is lower than the industry standard?

Table 55: Multiple choice

|  |  |  |
| --- | --- | --- |
| # | Choices | Answers |
|  | EcoGlow Pty Ltd may be more volatile with its financial position as it is a new business. |  |
|  | EcoGlow Pty Ltd has too much short-term and long-term debt. |  |
|  | EcoGlow Pty Ltd is taking longer than industry standard to collect customer payments. |  |
|  | EcoGlow Pty Ltd does not have enough investors funding it. |  |

# References and attributions

## References

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# Appendix: Links

Below is a list of all URLs linked in this workbook.

Table 57: URLs

|  |  |
| --- | --- |
| Link title | URL |
| Business directory and glossary (pdf) | https://share.tafensw.edu.au/share/items/44493bae-4b5e-4254-b28d-6d714656dfb6/0/?attachment.uuid=e7433cba-0f03-4eac-b72b-0faafa5f1076 |
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| Azure Beach Surf and Skate | https://share.tafensw.edu.au/share/items/1c89b5bb-2698-4ced-91d8-29a58efbaab2/0/?attachment.uuid=74f8070a-c4c0-4c14-a007-aedc47689889 |
| Fixed and variable cost examples (LinkedIn Learning, 3:03 min) | https://www.linkedin.com/learning/running-a-profitable-business-calculating-break-even/fixed-and-variable-cost-examples-14754114?u=57684225 |
| Compare your business now | https://www.ato.gov.au/businesses-and-organisations/income-deductions-and-concessions/small-business-benchmarks/compare-your-business-now |
| We give a buck® | https://www.money.com.au/ |
| Australian Bureau of Statistics | https://www.abs.gov.au/ |
| Profitability and earnings ratios: Margins (LinkedIn Learning, 5:45 min) | https://www.linkedin.com/learning/accounting-for-non-accountants/profitability-and-earnings-ratios-margins?u=1504 |
| Australian Business Statistics 2025 | https://www.money.com.au/research/australian-business-statistics |
| Markup vs Margin (YouTube, 1:38 min) | https://www.youtube.com/watch?v=tKpJJWL6Ze8 |
| Cl\_Finance\_TL\_Appx\_FnclTmplts (xlsx) | https://share.tafensw.edu.au/share/items/b7ae392b-2e9f-4db3-89a9-0caa32fd7b2e/0/?attachment.uuid=a793926c-2303-41d1-9273-7c7b2f2d4bad |
| How much does an hour of tradesmen's labor cost? (YouTube, 14:17 min) | https://www.youtube.com/watch?v=oVEitVj3NJA |
| Hourly Rate calculator | https://www.finder.com.au/business-insurance/hourly-rate-calculator |
| Develop a pricing strategy | https://business.gov.au/products-and-services/develop-a-pricing-strategy |
| Microsoft Copilot | https://copilot.microsoft.com/ |
| Set up a profit and loss statement | https://business.gov.au/finance/financial-tools-and-templates/set-up-a-profit-and-loss-statement |
| Balance sheet long description | https://share.tafensw.edu.au/share/items/b7ae392b-2e9f-4db3-89a9-0caa32fd7b2e/0/?attachment.uuid=649069a0-f6a4-4c76-ad3c-594e170be7eb |
| Business structures – key tax obligations | https://www.ato.gov.au/businesses-and-organisations/starting-registering-or-closing-a-business/starting-your-own-business/business-structures-key-tax-obligations |
| Tax basics for small business video series | https://www.ato.gov.au/businesses-and-organisations/starting-registering-or-closing-a-business/starting-your-own-business/tax-basics-for-small-business-video-series |
| Lodge activity statements with Xero | https://central.xero.com/s/article/Lodge-activity-statements-with-Xero |
| Get started with short-term cash flow in Analytics Plus (YouTube, 2:13 min) | https://www.youtube.com/watch?v=conYdwrDoKA |
| Grants and programs finder | https://business.gov.au/grants-and-programs |
| What debt collectors can and can’t do | https://www.accc.gov.au/consumers/debt/what-debt-collectors-can-and-cant-do |
| Investor briefing (pdf) | https://brandfolder.xero.com/8HSCTPAX/as/hq2q4n3k38qmfts5xvjvf6/Xero\_Investor\_Deck\_H1FY25 |
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| Understanding leasing vs. buying (LinkedIn Learning, 3:17min) | https://www.linkedin.com/learning/accounting-foundations-leases/understanding-leasing-vs-buying?u=57684225 |
| Capital: Definition, How It's Used, Structure, and Types in Business | https://www.investopedia.com/terms/c/capital.asp |
| 20 Things All Entrepreneurs Should Know About Angel Investors | https://www.forbes.com/sites/allbusiness/2015/02/05/20-things-all-entrepreneurs-should-know-about-angel-investors/ |
| Capital vs. operational expenses (LinkedIn Learning, 2:46 min) | https://www.linkedin.com/learning/certified-information-privacy-manager-cipm-cert-prep-1-privacy-program-development/capital-vs-operational-expenses?u=57684225 |
| Capital budgeting overview (LinkedIn Learning, 3:53 min) | https://www.linkedin.com/learning/finance-foundations-2018/capital-budgeting-overview-23073220?resume=false&u=57684225 |
| Create a budget | https://business.gov.au/finance/financial-tools-and-templates/create-a-budget |
| Make a budget that works (LinkedIn Learning, 3:10 min) | https://www.linkedin.com/learning/personal-finance-tips-and-tricks/make-a-budget-that-works?resume=false&u=57684225 |
| SMART Goals: How to Determine And Set Goals You Can Achieve | https://www.personatalent.com/business/how-to-set-acheivable-smart-goals/ |
| Goal setting (LinkedIn Learning, 2:34 min) | https://www.linkedin.com/learning/leading-yourself/goal-setting?resume=false&u=57684225 |
| Identifying key performance indicators (LinkedIn Learning, 3:35 min) | https://www.linkedin.com/learning/chief-technology-officer-career-guide/identifying-key-performance-indicators?resume=false&u=57684225 |
| How to Track Your Sales Using Excel in Under 5 Minutes 2024 (YouTube, 2:24 min) | https://www.youtube.com/watch?v=-vW-Q-Oyyts |
| How to Create Financial Reports in Xero (P&L, Balance Sheet) (YouTube, 4:48 min) | https://www.youtube.com/watch?v=Fu4fcwcIGLg |