
PR1- A2: Consultant Training Toolkit

Chapter no.: 8

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1.0 Information about Chapter

Chapter's title: Financial Skills
Duration: 8 hours
Short introduction to the chapter: Financial skills chapter aims at familiarizing with the most common items related to SMEs financial management.
Methods of instructions: Presentation, debates, exercises
Prerequisites of the students: At least one year of managing a SME
Learning aims and Objectives: • Financial skills are very important in crisis times, due to the fact that financial resources are reduced, so efficient management of those resources is necessary. • Learning objectives pursued: - To understand the financial statements - To know how to budget the company activity. - To know how to calculate the Break-Even Point (Critical Sales Point) - To know tips and tricks for a successful financial management - To know where to find programs/platforms that support SMEs for financial management.
Learning Outcomes Covered: • Understanding the financial statements • Budgeting the activity

- Break-even point (critical sales point)
- Tips and tricks for a successful financial management

Skills and Competences:

At the end of the chapter the learner is expected to acquire the following competencies, which will help her/him to take better decisions related to financial management:

- Financial planning skills
- Analytical skills
- Calculation skills
- Monitoring the efficiency of resource allocation and utilization
- Identifying and preventing the risks related to financial management

2.0 *Information about each individual subchapter*

Subchapter title: Understanding the financial statements

A short introduction to the subchapter:

Financial statements summarize the accounting records of the company's activity during a fiscal year and offer information about the performances of the activity, and financial health and, also, are used to make estimations for the future development of the company.

Financial statements show how well is managed the company, including information about its assets, its debts, its financial result (profit/loss) and how efficient is cash management.

The main financial statements include:

- **the BALANCE SHEET**, also called the **statement of financial position**, is an overview of the **company heritage/** net asset, including information about the assets, liabilities and shareholder's equity at the end of the fiscal year.

The money that enters into the company – financing resources- are included in the Passive section (Shareholder's Equity and Liabilities) and their destination is presented in the Assets section (Long Term Assets and Current Assets)

Taking into consideration that the financing sources are used for assets exploitation, the balance sheet equation is as follows:

ASSETS (LONG-TERM & CURRENT) = SHAREHOLDER'S EQUITY + LIABILITIES

Assets are resources that generate future profits and could include:

- long –term assets, such as buildings, equipment, leasehold improvements, vehicles, long-term notes receivable, and intangible assets (software, goodwill, trademarks, property rights etc.)
- current assets, such as cash, accounts receivables, inventories, prepaid expenses

The liabilities section includes all the debts of the company at the date of the balance sheet, as follows:

- long-term liabilities, such as loans payable, mortgage payable, and notes payable
- current liabilities, such as accounts payable, accrued expenses, unearned revenues, lines of credit

The format of the balance sheet could be different from country to country, depending on the accounting and fiscal legislation.

A simple format of the balance sheet, showing the correlation of the period for which the funding sources are available for the company and their destination is presented on slide 5.

Based on the balance sheet information, various liquidity or solvency indicators can be calculated, such as:

CURRENT LIQUIDITY = CURRENT ASSETS / CURRENT LIABILITIES

This indicator shows us if the business has enough liquidities to cover its current debts and it is recommended to be supra-unitary (> 1)

GENERAL SOLVABILITY = ASSETS / LIABILITIES

This indicator shows us if the business has enough resources to meet all debts, both long-term and short-term and it is recommended to be supra-unitary (> 1)

- **the INCOME STATEMENT** – an overview of the **revenues and expenses**, net income recorded during the fiscal year reported and is used for establishing the **net profit** of the company and to calculate different profitability indicators.

There are a lot of formats for income statements, depending on the accounting and fiscal legislation. A simple format of the income statement, which could be used also for calculating the break-even point, is presented on slide 8.

For the manager, the income statement is important because allows the analysis of the profitability, of the opportunity of some expenses (eg. promotional expenses, labour productivity).

It can serve as a model for forecasting the income and expenditure budget for the next period, and can also be used to analyse the efficiency of certain decisions relating to the investment projects envisaged.

- **the CASH FLOW STATEMENT** – an overview of **the way the cash was generated** during the fiscal year reported, to pay the debts.

There are a lot of formats for cash flow statements, depending on the accounting and fiscal legislation applied in each country.

A simple format of cash flow is presented on slide 10.

The cash flow statement summarizes also how changes in balance sheet accounts affect the cash account during the period reported.

For the manager, cash flow is very useful for forecasting and tracking receipts and payments related to the running of the business and, to be useful in monitoring is necessary a forecast at least monthly, even weekly.

Subchapter title: Budgeting the activity

A short introduction to the subchapter:

Budgeting the activity helps us to assess in which conditions the activity is profitable and it has in view the estimation of revenues and expenses generated by the activity of the company.

Usually, it has in view the pessimistic approach, meaning that the revenues are estimated at a minimum level and the expenses – at a maximum level, to minimize the risks related to the potential losses due to foregone revenues or unexpected expenses.

When estimating revenues, we have to consider the following aspects:

- the production capacity owned
- the level of the prices charged on the market in the case of the products/services we offer
- the number of potential clients that could be interested in our products/services, according to the information that we gathered from the market analysis
- recurrence of certain revenues

In the case of expenses, we have to consider the specificity of each expense, as follows:

- expenses with raw materials and utilities are estimated considering the unit supply prices and average consumption
- expenses with wages are estimated considering the average monthly salary for each category of staff
- expenses with rent are estimated considering the total surface that will be rented and the average rental rate per sqm.
- expenses with equipment depreciation are estimated considering their average duration of use (in some countries, like Romania, this is legally regulated)
- expenses with interest rate are estimated considering the interest rate applied by our bank or average interest rates on the interbank market, adding covering percentages

- expenses with insurance are estimated considering the insured value and the percentage applied by the insurance companies

When we estimate expenses, it is also recommended to take into consideration the estimated rate of inflation for the period, to have more realistic estimations.

If we intend to make investments in equipment or other assets, we could estimate the value of the investment considering the price of the offer selected after an analysis based on the technical performances provided.

Subchapter title: Break-even point (critical sales point)

A short introduction to the subchapter:

In pricing, especially in the case of a new product/service, great importance is attached to the analysis of the sales break-even point, which is the **minimum volume of sales that covers the total costs of the company in a certain period** (month/year).

To determine the sales break-even point, we must take into account the fact that the expenses involved in the production of a product/service behave differently depending on the volume of sales.

Thus, part of the expenses (such as those with raw materials, utilities consumed in the production process etc.) varies directly proportional to the volume of sales/production.

These are variable expenses and their value increases directly proportional to production volume.

In addition to the direct expenditure, other types of expenditure may also occur, even if not production /sales are recorded. For example, if we have rented space, we will have to pay monthly rent, regardless of how much we produce/sell. We also have to pay our accountant, administrative costs, insurance, etc., whether we record sales or not. These costs, which occur on an ongoing basis, regardless of the volume of sales, and remain relatively constant in value, are called fixed costs. From this we can draw the following conclusion: **the higher the volume of sales, the faster we can recover the fixed costs.**

Given the above, it follows that in the case of the break-even point we have the following relationship:

Sales (revenue) = Variable expenses + Fixed expenses (sales must cover total expenses)

physical volume of sales (q) x unit selling price (p) = unit variable expenditure

($VC/unit$) x physical sales volume (q) + fixed costs (FC)

This results in

$$q = FC/(p - VC/unit)$$

Why is break-even analysis useful?

First, it is a **simple profit planning tool**, that allows us to determine the physical volume of sales for which we obtain the desired annual gross profit (see slide 18)

Also, the break-even point is a **tool for assessing the development opportunity**, and the financial feasibility of a proposed investment (see slide 19)

The break-even point allows determining the **minimum selling price** (see slide 20) practice to obtain the desired profit.

The break-even point allows us to determine the **maximum variable expenditure** (see slide 21) to avoid losses.

Subchapter title: Tips and tricks for a successful financial management

A short introduction to the subchapter:

For successful financial management of the business is recommended to follow tested advice, as those presented below:

TRY TO BUILD UP RESERVES FROM YOUR PROFIT FOR COMPANY DEVELOPMENT OR TO COPE MORE EASILY WITH CRISES.

Those reserves will support company development and, in case of a crisis, will be useful for coping with this situation by having enough funds for maintaining the business until it restructuring its activity.

TRY TO NEGOTIATE A DEBT PAYMENT PERIOD LONGER THAN THE AVERAGE COLLECTION PERIOD OF YOUR CUSTOMERS.

This will ensure a positive cash flow for the company and allow it to avoid the financial bottleneck because the company collects receivables before the payment due date.

USE THE FUNDS AVAILABLE FOR LONG-TERM FOR INVESTMENTS AND DEVELOPMENT AND THE FUNDS AVAILABLE FOR SHORT TERM FOR CURRENT EXPENDITURE

Long-term available funds are better to be used for investment purposes, as investment costs are recovered from the company's results for more than one year.

If we use short-term available funds for investment purposes, we are likely to run out of cash for current expenses.

PLAN WEEKLY OR AT LEAST MONTHLY YOUR FINANCING NEEDS IN WRITING

This will help you to prevent a possible cash shortage and to take the necessary measures early on.

CONSTANTLY MONITOR YOUR CASH FLOW

This will help you to avoid situations likely to lead to cash shortages, by taking early measures to postpone payments or to speed up receipts

ELIMINATE UNNECESSARY COSTS, DON'T INVEST IN ASSETS THAT DON'T GENERATE FUTURE BENEFITS/PROFIT

For example, some managers use the profit for buying an expensive car, but this investment, in most small companies, doesn't generate future profit.

MAINTAIN A CLOSE RELATION WITH YOUR ACCOUNTANT, it could help you to optimize your taxes. Your accountant can inform you in advance about changes in tax legislation and can also recommend solutions to balance your financial situation.

DIGITISE YOUR BUSINESS DOCUMENTS

It helps to have more efficient management of the business because you could take decisions after analysing all the relevant documents, which could be accessed with a click.

OPTIMIZE THE COSTS RELATED TO THE LOANS

Do not offer banks collateral that far exceeds the value of the loan you are applying for; beware of hidden fees.

DON'T MIX PERSONAL MONEY WITH BUSINESS ACCOUNTS

If you mix personal money with business accounts, you won't most likely have a realistic view regarding the profitability and liquidity of your business.

Here are some links to the programmes that support SMEs' financial management:

<https://www.softwaretestinghelp.com/financial-management-software/>

<https://kissflow.com/finance/finance-management-software/>

<https://firmbee.com/solutions>

3.0 Detailed Instructions for the trainer

Chapter 8

Step 1: Trainer must first become familiar with the introduction, aims and objectives and learning outcomes of the chapter

Step 2: Trainer must teach the ppt file FINANCIAL SKILLS

Step 3: On slides 18, 19, 20, and 21 trainer must explain the case studies related to the usefulness of the break-even point.

Resources:

PPT:

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Readings: <https://www.investopedia.com/terms/f/financial-statements.asp>

<https://www.myaccountingcourse.com/financial-statements/balance-sheet>

Exercises: /

Videos:

Additional materials: /

4.0 References

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6. *Small Business Financial Literacy: The Beginner's Guide*,
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