

Essentials of Finance for Entrepreneurs

30th January, 2019



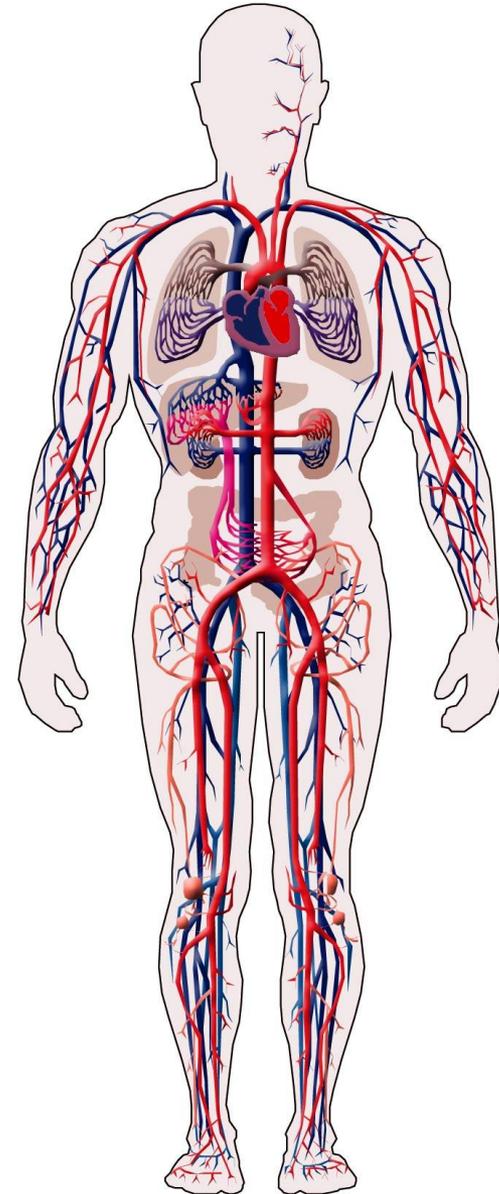
Hussain Moosajee

Experience the difference



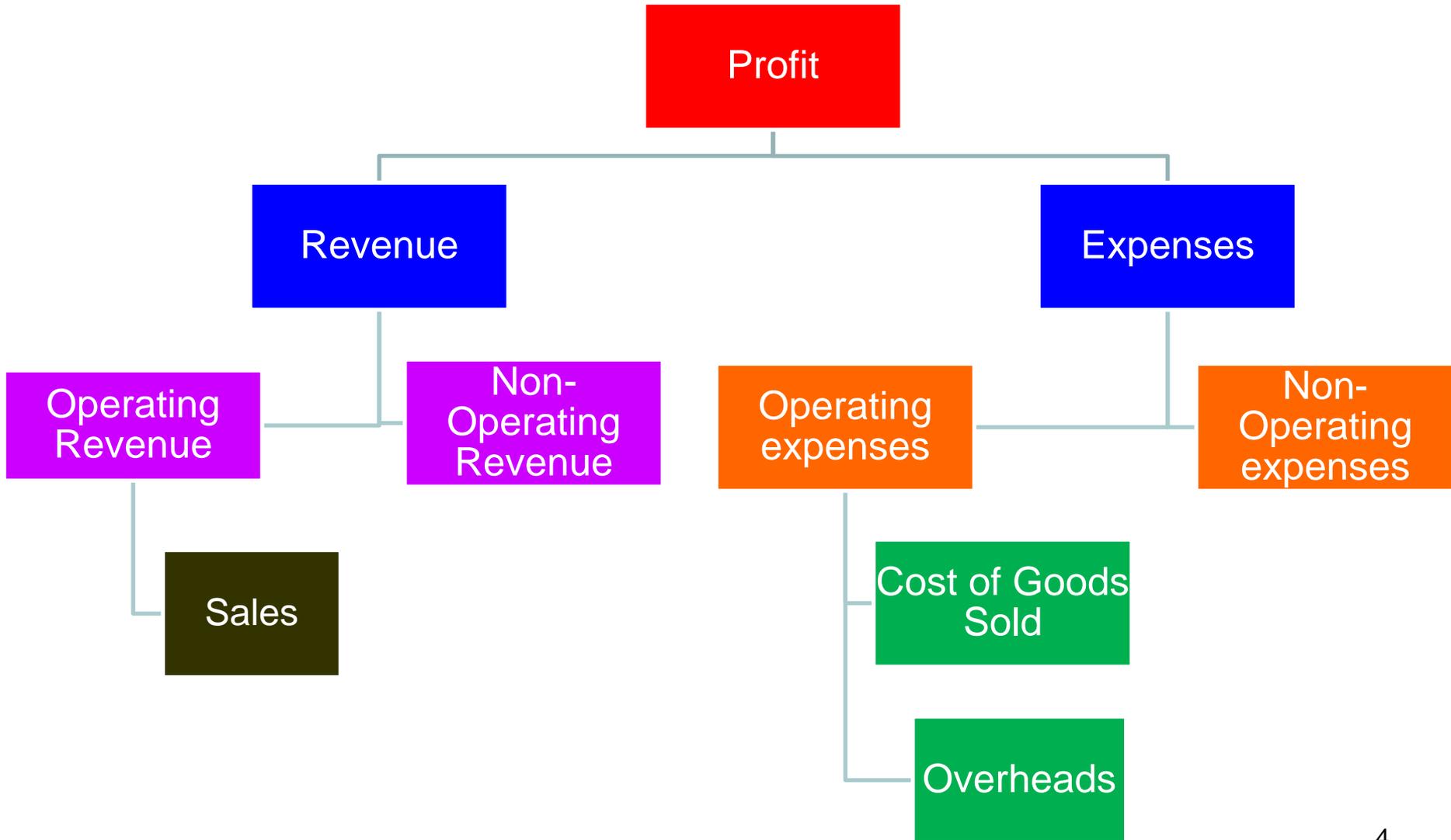


- Why would you think **Finance** is important to understand your business



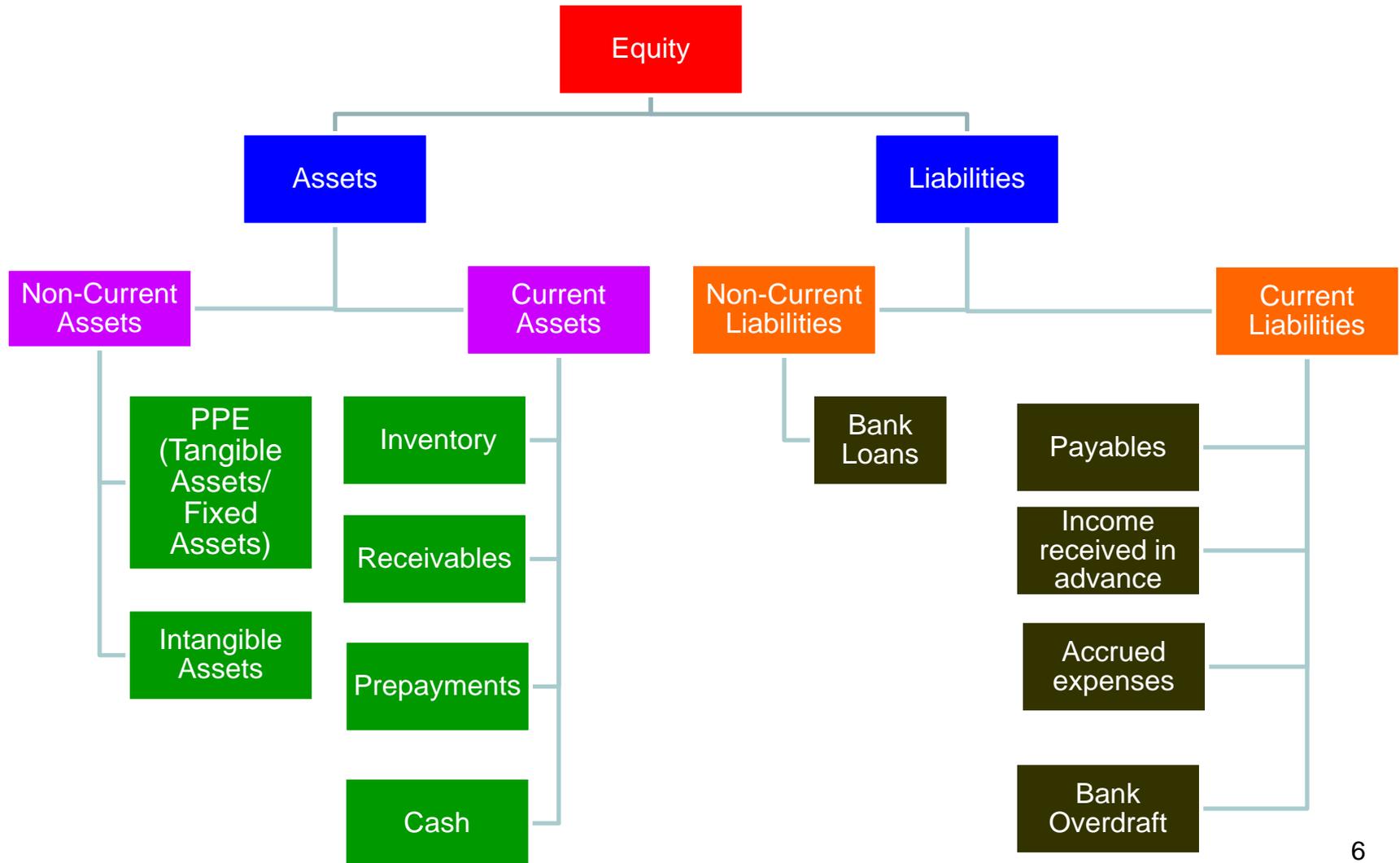


Relationship of Income & Expenditure accounts



- When is Income recognized?
 - When a customer order is received
 - When goods are manufactured
 - When goods are delivered or
 - When a service is rendered
 - When cash is received from the customer
 - Note:
Revenue is **earned** when a SALE is effected
(transfer of ownership), **NOT** when cash is received
- When is an Expense recognized
 - When the benefit of a service is obtained?
 - When cash is paid?
 - Note: The expense is **incurred** when the benefit of a service is obtained, and **NOT** when cash is paid

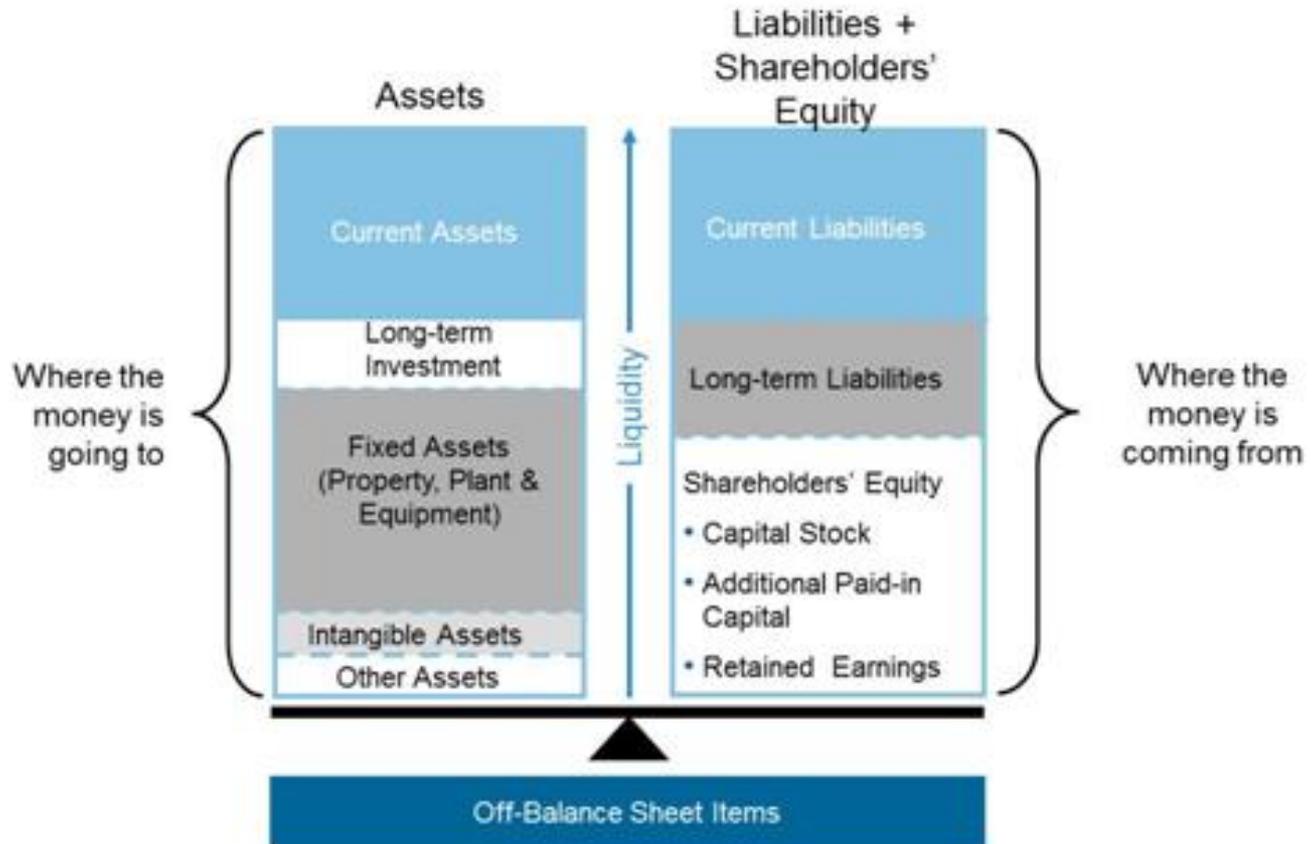
Relationship of Balance Sheet accounts



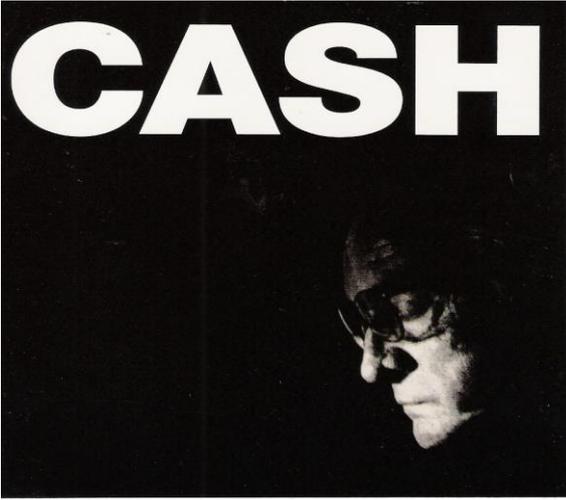
Structure of Balance Sheet

| Balance sheet for XYZ business on the 31 st of December 2010 | | |
|--|------------------|------------------|
| | \$ | \$ |
| ASSETS | | |
| <i>Non-current assets</i> | | 2,150,000 |
| Land and buildings | 2,000,000 | |
| Furniture | 12,000 | |
| Machinery | 18,000 | |
| Investments | <u>120,000</u> | |
| <i>Current assets</i> | | 10,000 |
| Inventory | 1,000 | |
| Debtors / receivables | 3,200 | |
| Bank and cash | <u>5,800</u> | |
| TOTAL ASSETS | | <u>2,160,000</u> |
| EQUITY AND LIABILITIES | | |
| <i>Owner's equity</i> | | 1,700,000 |
| Capital | <u>1,700,000</u> | |
| <i>Non-current liabilities</i> | | 440,000 |
| 10% Loan | <u>440,000</u> | |
| <i>Current liabilities</i> | | 20,000 |
| Creditors / payables | <u>20,000</u> | |
| TOTAL EQUITY AND LIABILITIES | | <u>2,160,000</u> |

Structure of Balance Sheet



CASH



CASH before you Crash!

Cash Management

Know your cash cycle

Cash may not show up for 30, 60 or 90 days. The longer it takes to collect, the more of your own or borrowed money you will need to use.



Cash drives everything.

Employees, suppliers, landlords, tenders are constants.

Suppliers may ask for payment before you turn them into a sale.

Match customer payment terms to your suppliers terms whenever possible.

Get deposits or retainers whenever possible.

Your Logo

Nature of Business & Revenue model

- Cash sales
- Credit sales

Burn rate

The rate at which a company spends cash to cover overhead costs without generating a positive cash flow is called the **burn rate**.

Use the burn rate to calculate how long a company can go without revenue.

Cash on Hand ÷ Burn Rate = Number of Months before
Cash Runs Out



Burn rate - explained

- Speed at which your cash balance is going down
- If you had Rs.1 million in cash on January 1st, and now it is October 1st and you have Rs.250,000 left, your burn rate is Rs.750,000/-, or Rs.83,333/month.
 - Rs.750,000 is the amount of cash that has been spent (Rs.1million minus Rs.250,000)
 - and 9 is the number of months that have transpired (January through end September)
- Being October 1st and you have Rs.250,000 left and your burn rate is Rs.83,333/month. How many months of cash do you have left? The amount of cash you have left divided by your burn rate ($250,000/83,333$) and you get **three months**. I.e: at year end, you will be out of money.



- Collections from Debtors
 - Minimum lead time from collection to receipt of cash (COD customers)
- Inventory
 - Re-order quantities
 - Stock holding quantities

Governance

**Personal transactions vs.
Business transactions**

Financial Projections

- Income & Expenditure account
- Cashflow

A Sales forecast

| | | Normal expected | | | | |
|---|--------------|-----------------|------------------|------------------|------------------|------------------|
| | | Deal pipeline | April | May | June | Total |
| Product (Unit sales) | | | | | | |
| Units by customer & by product | Black | 200 | 150 | 180 | 200 | |
| | White | 50 | 40 | 60 | 80 | |
| | Grey | 275 | 250 | 250 | 300 | |
| Selling price (Rs.) | | | | | | |
| | Black | | 1,500 | | | |
| | White | | 4,000 | | | |
| | Grey | | 2,500 | | | |
| Total Revenue (Rs.) | | | | | | |
| | Black | | 225,000 | 270,000 | 300,000 | 795,000 |
| | White | | 160,000 | 240,000 | 320,000 | 720,000 |
| | Grey | | 625,000 | 625,000 | 750,000 | 2,000,000 |
| | | | 1,010,000 | 1,135,000 | 1,370,000 | 3,515,000 |

Based on some industry analysis/
market study

Pricing

- Cost based Pricing

Based on a standard mark-up percentage

| | Product Cost | | Rs. |
|---|--|-----------------|--------------|
| 1 | Costs - directly associated with product | | |
| | Raw materials | 3kg @ Rs. 200 | 600 |
| | Packing materials | 1 box @ Rs. 50 | 50 |
| 2 | Labour | 2 hrs @ Rs. 250 | 500 |
| 3 | Production overheads | | 300 |
| | Cost of Production | | 1,450 |
| 4 | Admin and Marketing overheads - say 20% | | 290 |
| | Total Cost | | 1,740 |
| | Mark up - say | 25% | 435 |
| | Is this the Selling price ??? | | 2,175 |

What's your selling price ?

| | Rs. | Rs. | Rs. | Rs. | Rs. |
|----------------------------|------------|------------|------------|------------|------------|
| Selling Price | 2,175 | 2,500 | 2,700 | 2,800 | 3,000 |
| Cost of Production | 1,450 | 1,450 | 1,450 | 1,450 | 1,450 |
| Gross Profit | 725 | 1,050 | 1,250 | 1,350 | 1,550 |
| Gross Profit Margin | 33% | 42% | 46% | 48% | 52% |
| Overhead expenses | 290 | 290 | 290 | 290 | 290 |
| Profit | 435 | 760 | 960 | 1,060 | 1,260 |
| Net Profit Margin | 20% | 30% | 36% | 38% | 42% |

| | |
|----------------------|-------|
| Average Market price | 3,000 |
|----------------------|-------|

Segment Reporting - Example

| | Online sales | | | Offline sales | | | Consol Total |
|-------------------------|--------------|------------------|--------------------|---------------|------------------|---------------------|--------------|
| | Televisions | Washing Machines | Total Online sales | Televisions | Washing Machines | Total Offline sales | |
| Revenue | 850,000 | 1,700,000 | 2,550,000 | 1,900,000 | 3,500,000 | 5,400,000 | 7,950,000 |
| Cost of Sales | (629,000) | (1,105,000) | (1,734,000) | (1,501,000) | (2,450,000) | (3,951,000) | (5,685,000) |
| Gross Profit | 221,000 | 595,000 | 816,000 | 399,000 | 1,050,000 | 1,449,000 | 2,265,000 |
| | 26% | 35% | 32% | 21% | 30% | 27% | 28% |
| Administrative Expenses | | | (85,000) | | | (745,000) | (830,000) |
| Distribution Expenses | | | (205,000) | | | (18,000) | (223,000) |
| Operating Profit | | | 526,000 | | | 686,000 | 1,212,000 |
| | | | 21% | | | 13% | 15% |

- Total Revenue ?
- Total Expenses ?
- Total Profit ?

- Understanding the revenue and costs associated with a single transaction
 - Producing and selling a single unit

Unit Economics

Unit Economics

| | | Jan | | Feb | | March |
|----------------------------|----------|---------|-----|---------|-----|---------|
| | Per unit | Total | | Total | | Total |
| Units | | 300 | | 350 | | 400 |
| Revenue | 1,000 | 300,000 | 971 | 340,000 | 913 | 365,000 |
| Variable costs | 600 | 180,000 | 600 | 210,000 | 600 | 240,000 |
| Contribution margin | 400 | 120,000 | 371 | 130,000 | 313 | 125,000 |
| Fixed costs | 267 | 80,000 | 246 | 86,000 | 235 | 94,000 |
| Total Profit | 133 | 40,000 | 126 | 44,000 | 78 | 31,000 |

| | Feb | March |
|---------------------------------------|--------|----------|
| Additional units | 50 | 50 |
| Additional Revenue | 40,000 | 25,000 |
| Additional Variable cost | 30,000 | 30,000 |
| Additional contribution Margin | 10,000 | (5,000) |
| Additional Fixed cost | 6,000 | 8,000 |
| Additional Profit | 4,000 | (13,000) |

TLV vs. CAC

Life Time Value (LTV)

- Value a customer contributes to your business over their entire lifetime at your company.
- $\text{Gross margin \%} \times \text{Revenue per customer} \times \text{Life span}$
- $75\% \times \$40 \times 50 \text{ months}$
= \$1,500

Customer Acquisition Cost (CAC)

- Amount spent in acquiring a customer
- $\text{Sales and Marketing Costs} / \text{New Customers Won}$
- **Target TLV vs. CAC ratio**
- **3 : 1**

Key Performance indicators (KPI's)

- A measurable value that demonstrates how effectively a company is achieving **key** business objectives.
- Linked to determining efficiency levels
 - Monthly sales growth
 - Monthly Recurring Revenue - \$(MRR)
 - Annual Recurring Revenue - \$(ARR)
 - Gross profit and Net Profit margins
 - Breakeven level
 - Reject rates in production operations
 - Customer Conversion rate
 - Ageing analysis: Receivables & Inventory

Ageing analysis

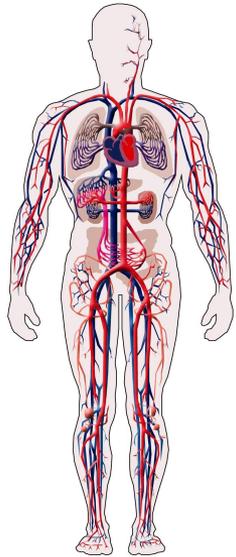
Accounts Receivable Aging Schedule
December 31, 20X6

| Customer | Balance | Current | Days Past Due | | | |
|---------------------|------------------|-----------------|-----------------|----------------|----------------|----------------|
| | | | 1 to 30 | 31 to 60 | 61 to 90 | Over 90 |
| C. Aaron | \$ 2,000 | \$ 2,000 | | | | |
| B. Ambroz | 1,900 | 1,100 | \$ 800 | | | |
| J. Baker | 1,300 | | | \$1,100 | \$ 200 | |
| W. Bruce | 1,500 | 800 | 700 | | | |
| H. Bunica | 2,000 | 2,000 | | | | |
| K. Carter | 600 | | | | | \$ 600 |
| E. Cline | 2,700 | 2,700 | | | | |
| All Others | 88,000 | 71,400 | 12,500 | 1,900 | 800 | 1,400 |
| Totals | \$100,000 | \$80,000 | \$14,000 | \$3,000 | \$1,000 | \$2,000 |
| Percentage | | 1% | 10% | 30% | 50% | 70% |
| Estimated Bad Debts | \$ 5,000 | \$ 800 | \$ 1,400 | \$ 900 | \$ 500 | \$1,400 |

| as at 31-Aug-2008 Valued based on Actual Purchase | | |
|--|--------------|----------------|
| 0 to 180 days | (> 180 days) | Negative Stock |
| Quantity | Quantity | Quantity |
| 1,580 Nos | | |
| 370 Nos | | |
| 1,210 Nos | | |
| 1,305 Nos | | |
| 15 Nos | | |
| 1,290 Nos | | |
| 695 Nos | | |
| 550 Nos | | |
| 145 Nos | | |
| 90 Nos | | |
| 10 Nos | | |
| 80 Nos | | |
| 10 Nos | | |
| 6 Nos | | |
| 4 Nos | | |
| 1,485 Nos | | |
| 50 Nos | | |
| 1,435 Nos | | |
| 20 Nos | 20 Nos | |
| 20 Nos | 20 Nos | |
| 205 Nos | | |
| 205 Nos | | |
| | | 3 more ... |
| Grand Total | 1,335 Nos | 310 Nos |

| | | | | |
|---|-----------------------------------|------------------|--------------------|----------------------------------|
| CPU Fan Main Location Raw Material Godown | 1,000 Nos 250 Nos 1,435 Nos | | 200 Nos 200 Nos | 1,485 Nos 50 Nos 1,435 Nos |
| Dual Core Processor Raw Material Godown | 20 Nos 20 Nos | 20 Nos 20 Nos | | |
| Hardware Manual Finished Goods Godown | 205 Nos 205 Nos | | | 205 Nos 205 Nos |
| Grand Total | | 1,335 Nos | 310 Nos | |

Our Learning?



CASH

Financial
Projections

Ageing Analysis

Profit Margins

Unit Economics

Income &
Expense
recognition

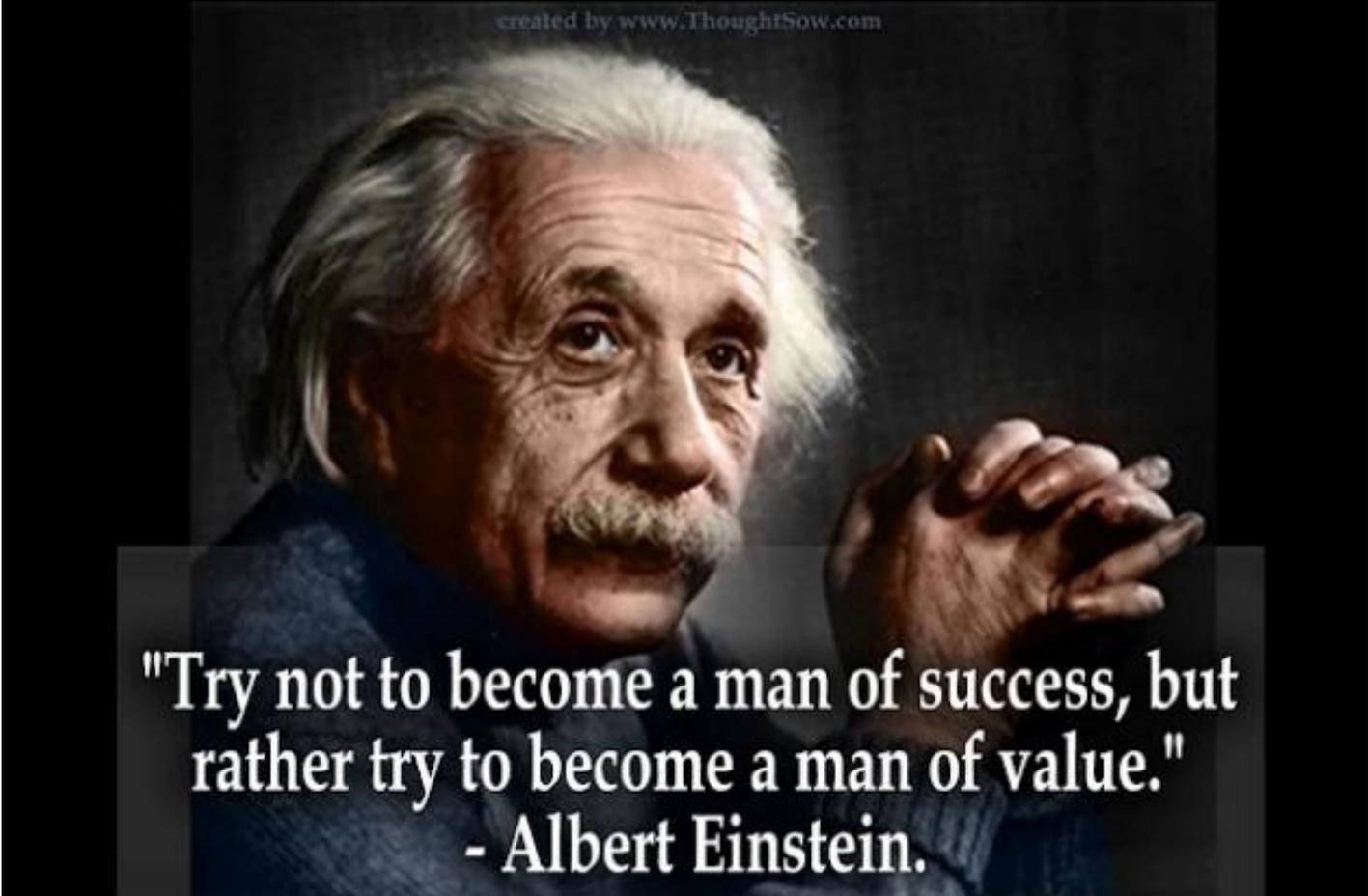
KPI's

Systems &
Procedures
and
Governance

Burn rate

LTV vs. CAC

created by www.ThoughtSow.com

A portrait of Albert Einstein, showing him from the chest up. He has his characteristic wild, white hair and a mustache. He is looking slightly to the right of the camera with a thoughtful expression. His hands are clasped together in front of him. The background is dark and out of focus.

**"Try not to become a man of success, but
rather try to become a man of value."
- Albert Einstein.**



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Experience the difference

