

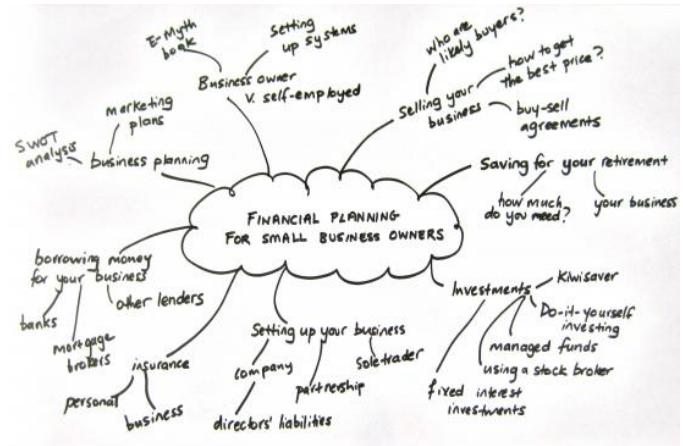
## B A 250: SMALL BUSINESS MANAGEMENT

### Lesson 4: Financial Planning and Managing Cash Flow

Introduction (1 of 11)

# Financial Planning and Managing Cash Flow

Think of yourself and/or your family as a small business operation. Do you dream about getting a new car, buying a new home, or taking a much-needed vacation? Do you have concerns about paying for your education? Do you feel strapped financially? Do you live paycheck to paycheck? Do you wonder if you can make ends meet? Whether you want to build a career within a large corporation's marketing department, devote your career to a non-profit organization, or start your own business, one thing is certain—you need to understand money. Money makes the world go 'round!



This lesson will introduce some of the basic financial planning steps needed to start a small business as well as ways to manage the cash flow of a small business.

A **financial plan** is a tool to help you manage your business more effectively. Design it carefully; be practical and realistic. There is a positive correlation between financial planning and the success of a new business venture.

## Learning Objectives

The readings and questions in the lesson should help you to do the following things:

- Outline the basic content of the income statement.
- Outline the basic content of the balance sheet.
- Use the income statement and balance sheet to compute a company's cash flow.
- Interpret financial ratios.
- Analyze financial statements using ratios.
- Outline the importance of a financial plan.

Key Terms/Concepts (2 of 11)

## Key Terms/Concepts

**accounts payable**

a current liability that represents when you owe your suppliers

**accounts receivable**

a current asset that represents what customers owe you

**assets**

found on the balance sheet, these are anything of value; broken down into current assets (those that get used up or turned into cash in a year or less) and fixed or long-term assets (which have a life of more than one year and must be depreciated)

**break even analysis**

a very simple financial tool that a business can use both before and after starting business; breaking even, in its most basic sense, is fixed costs (price per unit minus variable costs per unit) representing how many units a business must sell in order to have total costs equal total revenue

**expenses**

anything that relates to the operations of the business and is considered tax-deductible; subtracted from revenue to get taxable income

**liabilities**

expenses, legal debts, or obligations for which a business is liable; what a business legally owes a lender or creditor; current liabilities are short-term loans that must be paid back in a year or less, while long-term liabilities have maturities of greater than one year

**owner's equity**

any investment that the owner infuses into the business; can be an initial investment as well as a conservation of previous and current profit; assets minus liabilities

**profit**

what is left over after you subtract all your expenses from your revenue

**ratio analysis**

a financial tool that assesses business performance; calculating a variety of ratios over several years and then comparing the results over time is referred to as **trend analysis**

**revenue**

quantity multiplied by price; a business will total revenue over a period of time, such as a month, quarter, or year; located at the top of the income statement

# Road Map

<b>Readings:</b>	<ul style="list-style-type: none"> <li>• Complete the readings for Lesson 4 listed in the <a href="#">course syllabus</a>.</li> <li>• Read the online commentary for Lesson 4.</li> </ul>
<b>Assignments:</b>	<ol style="list-style-type: none"> <li>1. Prepare interview questions for the Small Business Owners Interview Paper.</li> <li>2. Complete the Small Business Owners Interview Paper.</li> <li>3. Meet with your team to plan for the Starting New Business Advice Presentation.</li> </ol>

Funding for Business (4 of 11)

## Funding for Business

Just like you might dream of or want a new car, new home, or much-needed vacation, businesses have wants and needs. Think about the different ways you generate revenue. The most common form of revenue for most people comes in the form of a paycheck. Sometimes, the paycheck isn't enough to get the things (assets) you want. So what do you do? You might fill out a FAFSA and get federal grants or student loans for your education. You may get a car loan for a car or a home loan for a new condo.

Businesses would love to have enough profit left over to fund their wants and dreams. But, in reality, just like most of our realities, it just isn't enough. So, just like you might need to search out sources of money (grants, loans, etc.), a business must do the same. This process is extremely difficult for a small business without a track record. That is probably one of the reasons why the TV shows *Shark Tank* and *The Profit* are so popular.

Not getting a grip on a business's finances is probably the biggest reason small businesses fail (and, for that matter, big ones, too)!

To improve the odds of being successful, it is imperative that the entrepreneur understand the finances of the small business—the sooner, the better. If it is being done correctly, analyzing the financial position will take place to some degree before the business even opens.

Don't you do your homework before spending large chunks of change? Do you just go out and say, "I need a new car" and then run to the closest dealership, pick the first vehicle you see, and say, "I'll take it"? No, you research the qualities of different vehicles; you consider your financial position and your needs; you consider if you can afford the car payment, and probably a variety of other factors; and then you make a decision.



Source: AndreyPopov/iStock/Thinkstock

This is very similar to what the entrepreneur must do. As individuals, we may place all this information in a document or spreadsheet. Businesspeople should use standard types of statements. Each of these statements (documents) provide important financial information about the business.

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The Financial Plan (5 of 11)

## The Financial Plan

Creating and understanding your business's financial plan is important as you attempt to seek out sources of financing. Your plan should include the statement of profit/loss (i.e., the income statement), a balance sheet, and a cash flow statement. We will take a closer look at these statements in the next few pages of this lesson, starting with the income statement.

### The Income Statement

The **income statement** is used to calculate profit or loss for a particular accounting period. The basic formula is shown in Figure 4.1.

#### *The Income Statement*

$$\text{Net Income} = (\text{Revenues} + \text{Gains}) - (\text{Expenses} + \text{Losses})$$

Graphic created in Microsoft Office (© 2012)

Source: The Pennsylvania State University

**Figure 4.1. The Income Statement**

- **Revenues** are the total resources a company receives from selling its products or services over specific periods of time.
- **Gains** are the profit on the sale of an asset.
- **Expenses** are money spent or costs incurred that are tax-deductible and reduce taxable income.
- **Losses** come from receiving less money from a transaction than you put into it.

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The Balance Sheet (6 of 11)

# The Balance Sheet

A **balance sheet** is a financial report showing a firm's assets, liabilities, and owner's equity at a single point in time. The formula in Figure 4.2 summarizes the balance sheet.



Source: The Pennsylvania State University

**Figure 4.2. The Balance Sheet**

The basic idea is that a company's liabilities and equity, taken together, must equal (or be "balanced" by) its assets:

- **Assets** are the total resources a company receives from selling its products or services over specific time periods.
- **Liabilities** are the legal debts or obligations that arise during the course of business operation.
- **Owner's equity** represents the owner's ownership (equity) in the business, as well as the amount of assets he or she owns. To calculate owner's equity, subtract liabilities from assets.

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The Cash Flow Statement (7 of 11)

# The Cash Flow Statement

Publicly held corporations are legally required to provide a Statement of Cash Flows to the U.S. Securities and Exchange Commission (SEC). Smaller businesses are not. As an entrepreneur, it is important that you have a basic understanding of your business's cash flow position. You should be able to create a Statement of Cash Flow (SCF), as important stakeholders might require it. If not, you should most certainly create a document that shows the cash coming into the business and the cash going out. A cash budget is an excellent financial tool for predicting or forecasting the net cash flow on a month-by-month basis for the upcoming year. If a business's cash budget shows a shortage for an upcoming month, the owner can start applying for small business loans, a business credit card, or a line of credit to be better prepared for the possible leaner times ahead.

# Statement of Cash Flows Formula

The **cash flow statement** is a financial report that shows a firm's sources of cash and uses of cash (Figure 4.3).

<b>Operating Activities</b>
Net Income
Depreciation
<b>+ Inflow from Operations</b>
<b>— Outflow from Operations</b>
Net Cash Flow from Operations
<b>Investing Activities</b>
<b>+ Inflow from Investing</b>
<b>— Outflow from Investing</b>
Net Cash Flow from Investing
<b>Financing Activities</b>
<b>+ Inflow from Financing</b>
<b>— Outflow from Financing</b>
Net Cash Flow from Financing
Increase or Decrease in Cash
Beginning Cash
<b>Ending Cash (as shown in the balance sheet)</b>

[link to the transcript for the above graphic](https://cms.psu.edu/section/content/default.asp?WCI=Goto&WCU=CRSCNT&MATCH=L4P9-STatementCashFlowsFormula) (<https://cms.psu.edu/section/content/default.asp?WCI=Goto&WCU=CRSCNT&MATCH=L4P9-STatementCashFlowsFormula>)

## Statement of Cash Flows Formula

### Operating Activities

Add Net Income, Depreciation, and Inflow from Operations together and subtract Outflow from Operations to yield the Net Cash Flow from Operations.

### Investing Activities

The Inflow from Investing minus the Outflow from Investing yields the Net Cash Flow from Investing.

## Financing Activities

The Inflow from Financing minus **the** Outflow from Financing yields the Net Cash Flow from Financing.

The Increase or Decrease in Cash plus the Beginning Cash equals the **Ending Cash** (as shown in the balance sheet).

Interview (8 of 11)

# Interview

One of the best ways to learn about small business is to talk to others who are doing it. It is said that experience is the best teacher. With every aspect of a business operation, there is much to read, investigate, and research. This lesson is designed to provide you with the little push or the encouragement to take advantage of the vast amount of knowledge available to you. The small business owner in your community has gained a lot of knowledge from the day-to-day experience of operating the business. You can learn from this person and interpret the material discussed in this course with his or her stories in mind.



Source: AdamGregor/iStock/Thinkstock

For the individual component of the [Owner Interview and New Business Advice](https://cms.psu.edu/section/content/default.asp?WCI=Goto&WCU=CRSCNT&preview=o&MATCH=New+Business+Advice) (<https://cms.psu.edu/section/content/default.asp?WCI=Goto&WCU=CRSCNT&preview=o&MATCH=New+Business+Advice>) project due in this lesson, you will need to select a small business owner/manager in your community and request an interview. Most people are proud of their work and very willing to share their knowledge. This is an opportunity to learn more about a particular field, shop, or business that has been of interest to you. Maybe it is a shop you've admired because of its products or appearance, a business that is very successful financially (which you've always been curious about), or that next career you dream about but have not yet gone into. In any case, this is an opportunity—take advantage of it.

Plan on talking for at least an hour (though it may take longer). Since small business owners/managers are very busy and work many hours, it will probably be necessary for you to adapt to their schedules. Go into the interview well prepared, with your questions defined and organized in advance. Think this through; plan on getting to the heart of your curiosity. Your effort will be more meaningful and useful to you.

## Sample Interview Questions

These questions should serve as a guide for the interview. Develop your own approach to the interview and try to collect as much information about these areas as you can. Remember, the objective is to pick this individual's brain to learn how they did it, what they did right, what went wrong, and what advice they can provide.

- **Obtain background information about the business.**
  - When and how was it started?
  - How has the business grown and changed over time?
  - Why was this form of ownership selected?
  - What are the key products/services?
  - Who is the chief competition?
- **Question the owner/manager about his/her own background.**
  - What was his or her education? Any business courses?
  - What is his or her experience operating other businesses?
  - What was the determining factor when he/she decided to go into business?
  - How does the owner feel about business? Can it be taught?
  - How important is education in running a business?
- **How is the business doing today?**
  - What is the business's major competition?
  - Is the business financially successful?
  - Is the business growing and expanding?
  - Who is the target market?
  - What kinds of advertising does the business use? How are they working?
  - Are there any production problems?
  - Is quality important? How?
  - How critical is appropriate pricing?
  - Is there a good source for suppliers?
  - How important is location?
- **How does the owner/manager handle employment and personnel issues?**
  - What is the most difficult human resource problem the owner/manager deals with?
  - How would the owner/manager define his/her management style?
  - Is there high employee turnover? If so, why?
  - How are employee benefits handled?
  - Are there any workers' compensation difficulties?
  - What kind of employee does the owner/manager feel would be the ideal for his/her business?
  - How can he/she get that type of person?
- **How are the business finances and accounting functions handled?**
  - Does the owner/manager feel comfortable reviewing and understanding financial data?

- What are the routine steps taken to record financial data?
- How is the banking handled?
- How are sales projections made?
- How does the owner/manager feel about taxes? Are they too high, too complex, and so on?
- How important is inventory control to the business's success?
- How difficult is it to obtain financing?

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Additional Interview Questions (9 of 11)

## Additional Interview Questions

These questions may provide additional insight:

- How important is customer service to the success of the business?
- Has the owner/manager ever used and prepared a business plan? Was it useful?
- What kind of impact does crime have on the business?
- Are crime prevention steps in place or planned?
- What impact has technology/the use of computers had on the business?
- Does the business have a website?
- Does the business conduct business electronically?
- What is the business's position in the community?
- Is community involvement important?
- How does the owner/manager balance social responsibility issues?
- Is the environment important?
- How does regulation affect the business?
- Is the business involved in any global opportunities? Why or why not?
- Is the international marketplace something to be considered?
- What is the outlook for the future?
- Is planning done to prepare and be ready to take advantage of opportunities?
- Does the national political scene have an effect on the business?
- What effect does the national or local economy have on the business?
- What are the largest challenges the business expects to face in the future?
- What does the owner/manager like best about operating his or her own business? What does he or she like the least?
- What advice/recommendations would the owner/manager have for an entrepreneur just starting out?

Writing Your Interview Narrative (10 of 11)

## Writing Your Interview Narrative

For this assignment, there are two deliverables:

- your typed interview questions, with the notes you took during the interview, and
- an interview narrative summarizing the interview.

Your typed narrative should include an opening, body paragraphs with a logical flow, and a closing paragraph that contains your answer to the question "What advice/recommendations would the owner/manager have for an entrepreneur starting a new business?" With the interviewee's permission, you may want to consider recording the interview so that you can review it as you work on your assignment.

## Opening

Provide background about the business (who, what, why, when, where) and include why you chose this business and/or interviewee for this project. The opening creates a setting for the body paragraphs that come next. One good practice is to start with an interesting anecdote or fact about the business or owner as an attention-getter that will draw the reader into your narrative.

## Body Paragraphs

These paragraphs should flow in a logical way (such as chronologically) and can include organizing headers to help direct and orient the reader. Starting each paragraph with a major idea and supporting the major idea through the sentences that follow is a good practice you can follow for this narrative. An example is *Jane Doe, the business owner, decided to start her small business the day she realized she had an answer to a problem that plagued many people she knew...* (followed by the owner's education, experience, and other supporting details).

## Closing

The closing should include summarizing statements, conclusions, and advice/recommendations from the owner/manager for an entrepreneur starting a new business. Remember to use proper grammar and punctuation (e.g., quotation marks around direct quotes) and a professional tone.

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Lesson Assignments (11 of 11)

## Lesson 4 Assignments

Complete all the following tasks and readings by the due dates listed in the [course syllabus](#).



### Small Business Owner Interview Paper

For this [individual assignment](https://cms.psu.edu/section/content/default.asp?WCI=Goto&WCU=CRSCNT&preview=o&MATCH=New+Business+Advice) (<https://cms.psu.edu/section/content/default.asp?WCI=Goto&WCU=CRSCNT&preview=o&MATCH=New+Business+Advice>) , you will need to select a small business owner/manager in your community and request an interview. The objective is to pick this individual's brain to learn how they started their business, what they did right, what went

wrong, and what advice they can provide. Plan on talking for at least an hour (it may take longer). Go into the interview well prepared, with your questions defined and organized in advance. Using the questions in this lesson's previous pages, develop your own approach to the interview and try to collect as much information as you can.

This assignment has two deliverables:

- your typed interview questions, with the notes you took during the interview, and
- an interview narrative summarizing the interview (750–1,000 words).

You are required to end your paper with a paragraph on the response you received to the question "What advice/recommendations would the owner/manager have for an entrepreneur starting a new business?"

This assignment is worth 10% of your grade. Please see the [Interview Paper Rubric](#) in the syllabus for details on how the assignment will be graded.

Submit your assignment to the [Interview Narrative Drop Box](#) (<https://cms.psu.edu/section/content/default.asp?WCI=Goto&WCU=CRSCNT&MATCH=Interview+Narrative>) . Please submit your paper as an **attachment** in the drop box.

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## Team Project: Begin New Business Advice Presentation

For the [group component](#) (<https://cms.psu.edu/section/content/default.asp?WCI=Goto&WCU=CRSCNT&preview=o&MATCH>New+Business+Advice>) of this assignment, based on your collective experiences with the interview, your team should meet virtually to begin planning your presentation on offering advice to someone starting a new business. Use the [New Business Advice Presentation Rubric](#) to guide you as you develop the presentation. Remember that you will be sharing a Collaborate recording of your presentation with the rest of the class.

This assignment is not due until the end of Lesson 5 and is worth 10% of your grade. Your team leader should post the link to the Collaborate recording to [Discussion Forum 6: Team Presentation Link](#) (<https://cms.psu.edu/section/content/default.asp?WCI=Goto&WCU=CRSCNT&MATCH=Discussion+Forum+6:+Team+Presentation+Link>) . All students are to then view each team's presentation and add constructive comments and reflection.

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