Starting a Business

Module 5: Managing Money

The Starting a Business Guide is designed in six modules so that you can select the ones that are right for you:

Overview
A summary of the material in other modules giving you the basic steps you'll need to take in order to set up your own business.

Is starting a business right for you?
Information and activities to help you decide whether running your own business will suit you.

Planning your business
Planning the practical and legal aspects of your business.

Finding and keeping customers
Researching the market, getting your business offer right and successfully selling to customers.

Managing money
The key skills needed to organise your business finances and how to apply for funding.

Your business plan
Collate the information that you wrote in the worksheets into an essential or comprehensive business plan.

What you will learn and understand as a result of working through this module

Module 5: Managing Money

This module will help you to:

- work out your profit and loss
- work out your costs
- work out your takings from sales
- work out how much money you'll need to run your business
- set up and manage your cashflow
- understand what financial records the law requires you to keep

You'll also have the opportunity to complete the parts of your business plan that are about finances.

How to use the module

This is a self-help module, with both reference and worksheet material to help guide you through starting a successful business.

As you go along, there are worksheets to complete, and you can make notes in the action plan about what you need to do next.

You'll find information throughout the module to help guide you:

- Tips for how to make the most of your business
- An action plan at the end of this module to help you plan your activity for starting up.

Module 5: Managing Money

Planning your money

Raising finance

Working out your profit

Managing cashflow

Managing the risks

Keeping financial records

Glossary

Action plan

Planning your money

In this section you will:
• calculate your sales
• calculate your business costs
• calculate the start-up costs for your business.

Starting a business is potentially an exciting opportunity to make money and fulfil your financial needs. But before you set out, you'll need to spend some time planning how much money you're likely to make, and what it's all going to cost. You'll also need some basic business skills like bookkeeping.

You will need to put together a reasonably
accurate forecast of:

• your sales – how much you're likely to sell
• your costs – how much you'll need to start up and what the running costs will be
• your profit – how much you'll need to break even and make a profit.

It doesn't have to be complicated. You simply need to work out what you're likely to earn and spend, based on the market research you've done and your realistic judgement.

Forecasting your sales

Begin by listing the number of customers
you think you could have in your first three years. Then put a realistic sales figure against each one, bearing in mind that a few larger customers are likely to account for a greater share of sales than the rest - although this depends on your type of business. You'll have to do some educated guesswork, but at least you should reach a forecast that's broadly in the right area. You will need to estimate how much each will buy and at what price.

Calculating your costs

Costs are the amount you spend on selling a product, running a production process, or delivering a service. Typically, your business will have three kinds of costs:

Variable costs: Cost items that vary depending on the level of your sales. These could include, for example, the raw materials for making your product and staff overtime.

Fixed costs: Things that always have to be paid however much you sell such as rent, rates, utilities, salaries, travel, stationery, insurance, advertising and promotion.

Capital costs: One-off costs such as buying computer equipment or premises.

Working out your start-up and running costs will enable you to see how much of your own money you'll need to put in, and how much finance you'll want to raise.

As well as establishing what your start-up costs will be, you'll need to work out what it will cost to run your business each year, and to produce a realistic forecast of how much money you'll need to survive until your business starts making money.

Put into your action plan any research you need to do into items and their likely cost.

Tip
If you're thinking of borrowing money for your business always first talk to your Launchpad Business Adviser

Worksheet: Start-up costs

Sales forecast
Your estimated total sales over each of the first three years.

	Expected numbers of customers		Sales figure per Customer £		Expected total sales £
Year 1		x		=	
Year 2		x		=	
Year 3		x		=	

You will use your total sales figures later in section **'Working out your Profit'**

Start-up costs

Calculate how much money you need before you start trading	**£**
IT and computers	
Telephones and broadband	
Equipment	
Stock	
Tools	
Vehicles	
Professional fees	
Insurance	
Rent/rent deposit	
Stationery	
Marketing	
Consumables	
Licences	
Training	
Association fees	
Wages/recruitment	
Security/health and safety equipment	
Market research costs	
Subscriptions	
Other: (please specify)	
Total start-up costs	
Your contribution to these costs	

Your variable and fixed running costs

Getting a firm idea of your different costs will help you plan financially for your business. List as many costs as you can identify in each section. You will use the figures later in the module in sections **'Raising Finance'** and '**Working out your Profit'**

What are your estimated variable costs? Remember to allow for both any up-front costs as well as ongoing charges.

Item	**Year 1**		**Year 2**		**Year 3**	
	One-off	**Ongoing**	**One-off**	**Ongoing**	**One-off**	**Ongoing**
Goods						
Materials						
Extra labour						
Transport						

What are your estimated fixed costs?

Item	**Ongoing annual costs**
Premises (incl. rent, rates, utilities)	
Telephone and broadband	
Printing, post and stationary	
Advertising and promotion	
Bank charges	
Professional services	
Insurance	
Bank interest	
Equipment and vehicle leasing	
Other (please specify)	

Raising Finance

In this section you will:
- work out the minimum you need to earn from the business in the first year
- work out what you might need to borrow to start the business.

When you're starting up, you're likely to need money to buy equipment and meet marketing costs - all before the first sale is made. Then once you're trading, you'll need cash to pay the bills and keep the business going, including your living expenses.

There are a number of sources of finance available including:
- your own money
- funding from family, friends and community
- bank loan or overdraft
- equity investment
- grants & government schemes.

Money from other sources

Most start-up businesses fund themselves through overdrafts and loans. If the value of assets you have available for your business is greater than the total borrowing requirements, you may be able to raise finance from a commercial lending institution.

Before they agree to lend you the money, your source of finance (including family and friends) will want to know that you're a good risk. They will usually want you to:
- present a credible business plan
- offer security for any money they lend you
- invest some money in the business yourself.

You need to be sure the business will generate enough profit to repay the loan and the interest. Whatever type of borrowing you use; you may have to pay arrangement fees as well as interest. If there are insufficient assets to provide security for start-up costs think about whether you could spread the start-up costs over a longer period.

Especially if you are borrowing from friends and family, carefully consider the risk of a damaged relationship and the fact that they could lose their money if your business fails.

In the next three worksheets you will:
- calculate your personal survival budget
- decide how much you can personally contribute to the start-up cost
- calculate what assets you might be able to use as security to raise finance for the business
- calculate how the business will repay any loan you take out to fund starting up.

Worksheet: Personal survival budget

	£	£
Estimated annual personal expenditure		
Mortgage and/or rent		
Council tax		
Utilities (gas, electricity, water etc)		
Personal and property insurance		
General housekeeping expenses (food etc)		
Phone and Internet		
Car tax and insurance		
Car running expenses		
HP repayments		
Hire charges		
Subscriptions to journals, professional bodies etc		
Savings plans & pension contributions		
Contingencies		
Tax		
National Insurance		
Leisure/Socialising		
Hobbies		
Other (specify)		
+		
Total personal expenditure =		
Estimated personal income (after tax)		
Income from family, partner		
Other income (specify the source) **+**		
Total personal income =		**-**
Total survival income required from the business (after tax)		**=**

If your estimated personal income is more than your estimated personal expenditure, this means you may have additional funds to invest in the business.

Assets you could use to raise finance

	£	£
Personal assets		
Value of house		
Value of other property		
Surrender value of insurance policies		
Cash deposits in banks or building societies		
Stocks and shares		
Value of car(s)		
Other reliable assets		
(things you can sell to raise money – specify) **+**		
Total assets =		
Liabilities		
Outstanding mortgage		
Other outstanding loans (eg car loan) **+**		
Total liabilities =		-
Estimated net personal assets		=

Sourcing finance

Use the figures you have now calculated to set out how much you'd like to borrow for the business, the assets you have as security, and how the business will repay the loan.
If your estimated personal income is more than your estimated personal expenditure, this means you may have additional funds to invest in the business.

	£
Total borrowing requirements for the business	
Start-up costs	
Personal start-up contributions	
Other start-up contributions	
Total required =	
The assets you have available as security	
Estimated net personal assets (from table above) =	

You will take these figures calculated here into your profit and loss calculations and your cashflow manager

Do you need to make any plans or take any actions to raise finance?
Place these in your action plan.

Case Study
Here's how I found the right sort of finance for my new business

Working out your profit

In this section you will:
- prepare a detailed profit and loss forecast for your business
- calculate a break-even for your business.

No matter what type of business you are in, a primary objective of business is to make money. It is the profit from your business that will allow you to realise your personal financial goals of owning your own business. Even if you are operating a not-for-profit or social enterprise, making money to put back into the business or community will be key to your success.

One of your most important financial tools is the profit and loss forecast. This shows your sales, expenditure and what level of profit you expect your business to produce by the end of the forecast period, usually at monthly, quarterly and annual reporting points.

Your profit and loss forecast calculates your gross and net profit. Gross profit is the amount you have after subtracting direct costs from your sales. This is an important figure as it shows if you are making enough sales to cover the basic costs associated with your goods or service. The profit and loss forecast then deducts your fixed costs from the gross profit to calculate your net profit. This includes any loan repayments you need to make as well as depreciation on your capital expenses. If you have a positive net profit this means your company is making money after all your expenses are accounted for. It is your net profit on which you will pay tax

What is break-even?

Every business needs to know the level of sales necessary to break-even. Break- even is the amount of money you need to bring into the company to cover your costs including your survival income (section **'Raising Finance'**). If you do not bring in at least your break-even then your business will be losing money and will be unsustainable.

If you compare your actual sales with your break-even point every month, you'll be able to see immediately whether you're making a profit, making a loss or just breaking even.

To work out your break-even, you need to know both your variable and fixed costs (see section **'Planning your money'**). You can think about break-even in terms of the total money you need to bring in or in the number of units you need to sell to cover all of your costs.

Worksheet: Helping you to understand break-even

The following worksheet shows an example of a business which needs to think about how many customers will buy its products, therefore it is helpful to think in terms of units.

$$\text{Break-even (units)} = \frac{\text{Total fixed costs (£)}}{\text{Selling price per unit - variable cost per unit}}$$

A market trader can rent a market stall for £50 per day. He aims to earn £100 per day - his wage (drawings). He sees himself as breaking even when he gets his wage and covers his costs. He buys his goods on sale or return and has to pay his supplier £10 for each product sold. He has no other costs. He sells his products at £15 each.

Answer the following questions:
a) What kind of cost is the rent?

b) What kind of cost is the amount paid for goods sold?

c) How many does he have to sell to break-even?

d) What is the effect on break-even of reducing his rent to £35?

e) Why is it important to calculate the break-even figure?

f) What could he do differently to improve his break-even?

Worksheet: Your profit and loss forecast

A profit and loss forecast allows you to manage your business on an ongoing basis. It will also be important if you apply for funding.

	Year 1 (£)	Year 2 (£)	Year 3 (£)
Total expected sales			
Less variable costs			
Gross profit (sales less variable costs) =			
Calculate your gross profit margin (gross profit ÷ total sales x 100)	%	%	%
Your annual projected fixed costs			
Salaries/wages (survival income + any staff)			
Premises (including rent, rates, utilities)			
Telephone and broadband			
Printing, post and stationery			
Advertising and promotion			
Bank charges			
Professional fees			
Insurances			
Bank/HP/interest (payable to your bank)			
Equipment and vehicle leasing			
Depreciation			
Other			
+			
Total fixed costs =			
Net profit (gross profit less total fixed costs) =			
Calculate your net profit margin (net profit ÷ total sales x 100)	%	%	%

Can you identify any ways of decreasing your break-even point, while maintaining your product/service offering (eg reducing costs or increasing price)? Put any actions that arise into your action plan.

Managing cashflow

In this section you will:
Create a cashflow forecast for your business.

Cashflow is all about managing how much cash you have immediately available for running your business. If you don’t have enough cash, or assets you can quickly turn into cash, to pay your bills you may be legally insolvent and will have to take immediate action. Don’t forget that if you don’t pay all your outstanding debts, you may make another small business bankrupt as well. Having a positive cashflow is therefore very important.

A cashflow forecast shows the income and expenditure you expect in the business and the resulting surplus or shortfall that will occur each month. Your cashflow shows how much money you have in the bank and what is coming in and going out. It’s vital that you know the state of your cashflow – that is, where your money it’s going.

Managing your cashflow is an important aspect of your business activities. Ensuring you are getting paid on time and that you are able to pay your suppliers is essential to keeping your finances healthy. Even businesses that show a good profit on their profit and loss statement can fail because they do not manage their cashflow properly.

Worksheet: Your cashflow forecast

Banks and investors will want to see your cashflow forecast if you apply for finance from them. It is important to allocate the income or expenditure to the month in which it is received or paid.

Managing the risks

It is important to have an understanding of the things that will affect your financial forecasts, such as sales not growing as expected, an important piece of machinery breaking down or a supplier going out of business. By understanding these risks, you can prepare yourself to tackle the challenges.

Worksheet: Managing financial risks

The risks that you've identified for your financial forecasts are:
eg supplier fails to deliver

How you will minimise their impact:
eg spread purchases across a number of suppliers

Are there any actions you can take now to minimise your identified financial risks? Put these into your action plan.

Keeping financial records

You're required by law to keep financial records relating to your business, and the bank may ask you to produce records and statements if you apply for finance from them.

Many people starting their own business dislike keeping records, but it does have many plus points:

- it helps you manage your business so you know how you are doing
- it saves you time whenever you need figures to hand
- it helps keep you up-to-date with how much you owe and how much you're owed
- you can be sure that you're only paying the tax you owe.

When you're starting up, it's usually a good idea to do the bookkeeping and run the financial management systems yourself. You'll then understand how it all works and, if you delegate the work to a bookkeeper later, you'll know what to look for and how to keep everything under close scrutiny. There are a number of excellent proprietary software packages widely available.

What should your system include?
As a minimum you need a bookkeeping system that keeps track of your banking, sales, bills that have to be paid, money that you're owed and purchases. Some good software packages are available to help you keep your books.

There are six basic sets of financial records that will help you run a tight business:

• profit and loss
• cashflow
• the cash book/spreadsheet
• the sales ledger/spreadsheet
• the purchase ledger/spreadsheet
• the wages book/spreadsheet.

You'll need to keep financial records for six years. This includes cheque-book stubs, bank statements, invoices received and sent out and staff records, such as those relating to PAYE and petty cash receipts.

Choosing an accountant

Accountants can offer you a range of services from preparing financial statements for your end-of-year tax return to specialist business advice. They can save you time and help to make your business more profitable.

We recommend that you use someone who has professional accounting qualifications.

- How are you going to manage your financial records?
- What system will you use?
- Do you need to bring in external advice or accounting services?

Decide what you need to do and put any actions in your action plan.

Case Study
Here's how I used an accountant to help me in my business

Name:

Company:

What I did

Glossary

Annual costs
The running cost of any item over a 12-month period

Assets
The value of things owned or owed to the business

Break-even
The level of sales required to cover all business costs, so neither a profit or loss is shown

Capital costs
The costs incurred on the purchase of land, buildings, construction and equipment to be used in the production of goods or the rendering of services

Cash book
A cash book is used to record all cash receipts and payments

Cashflow forecast
An estimate of the cash needs of the business and the flow of that cash in and out of the business account

Creditor
Someone to whom the business owes money

Current assets
Cash or assets which are expected to turn into cash within 12 months

Current liabilities
Monies owed by the business due for repayment within 12 months

Debtor
Somebody who owes the business money

Depreciation
Depreciation means the cost of the asset is spread, so it is written off against the profits of several years rather than just the year of purchase

Fixed assets
Assets owned by a business for use over a long term, such as premises or equipment

Fixed costs
Costs that stay the same whether there are no sales at all or whether they go up or down

Gross profit
Total income from sales less variable costs

Gross profit margin
The difference between value of sales and variable costs, as a percentage of total sales

Insolvent

When the business cannot pay its debts, even if it sells all of its assets

Liabilities
The value of things owed by a business to somebody else

Net profit
Total income less total expenditure

Profit and loss account
A statement which shows a business' total income and expenditure for a specific period

Purchase ledger
A ledger that records all purchases made by the business and the money owed at the end of the month

Sales ledger
A record of the sales your company has made, the amount of money received for your products/services and the money owed at the end of the month

Start up Cost
The total of all the items you need to be able to operate on day one

Turnover
Total sales income for the year

Variable Costs (Also known as costs of sales and direct costs)
Costs that vary in line with the level of sales for example raw materials

Wages book
A record of all salary payments made, including NIC and PAYE

Working capital
The value of current assets less current liabilities

Action plan

By working through this module you've taken an important step in deciding whether starting a business is right for you.

Take a few minutes now to write down any additional actions you want to take to move your business idea forward.

What needs to be done	By whom	Date
1		
2		
3		
4		
5		
6		
7		
8		
9		
10		
11		
12		
13		
14		
15		
16		
17		
18		
19		
20		