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Community Innovation: From Idea to Implementation

International Online Seminar: Session 9

How money works in business – Profit, Loss and Liquidity Plan, Prof. Dr. Monica Dudian, ASE

Tuesday, 26th of November 2019, 16 00 – 17 30 CET






Recap on where a business's money comes from ...

Own equity/Shareholders
Family/Friends
Donations
Grants
Crowdfunding
Loans etc



But how is this cash to be spent?

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<p>Things the business needs to go directly into what it sells</p>	<p>Things the business needs but are not intended for sale</p>	<p>Things the business must pay for whether it trades or not</p>
<p>Raw materials, factory heat, light and power, wages for factory workers = Working capital</p>	<p>Things that have to be bought to produce goods and services, like vehicles, buildings, machinery = Fixed assets</p>	<p>Rent and rates, telephone bills, office staff salaries, stationery etc. = Administration costs</p>

Start-up costs = amount paid or incurred for creating an active trade or business

Types of cost	Examples
Facilities costs=related to the company location	Rent/Lease, construction, utilities, other costs for preparing the location for the business use
Business Equipment and Vehicles	Office equipment and furniture, specialized equipment for production, computers, software, computer networking equipment, phones
Business supplies and advertising materials = supplies and materials you need to have when you start the activity	Office supplies (invoices, sales receipts, paper towels etc.), business cards, website setup, brochures, flyers etc.
Other Startup Costs	Fees to set up the legal form of the business (attorney), licenses, permits, insurance etc.
Miscellaneous expenses	A buffer for any unexpected cost
Total start-up costs statement = the amount you will need to get financed for your startup	

The income statement

- As long as you have the list of income and expenses, you can transfer it into the financial statement.
- The profit and loss statement is the most important financial statement any business needs, because it demonstrates whether or not a business idea is viable. It displays the financial performance of a business over a specified period.
- Reviewing the profit and loss statement helps the manager make decisions. Your business will also need a P&L when applying for funding for any new business project.

The P&L Statement: example

	2020
REVENUES (Euro)	
Product sales	50000
Other Income	5000
Total Income	55000
EXPENSES (Euro)	
Advertising	2000
Bank Charges	4000
Office Expenses	5000
Cost of sales (cost of the direct materials, direct labor costs)	25000
Miscellaneous	500
Travel, meals	0
Taxes	3000
Total Expenses	39500
NET INCOME	15500

The Income Statement

	Y1	Y2	Y3
REVENUES	0	0	0
Fees			
Memberships			
Donations			
Sales			
Loans			
Grants			
Other revenues			
EXPENSES (COSTS)	0	0	0
Salaries (including taxes)			
Materials			
Utilities			
Rent-buildings			
Rent - machinery			
Depreciation - machinery			
Repairs and maintenance			
Patent/software amortization			
Tools used			
Insurance on building and machinery			
Advertisements			
Sales commission			
Traveling expenses			
Packaging expenses			
Postage and telegrams			
Telephones			
State and local taxes			
Accounting and auditing			
Legal			
Other expenses			
INCOME FROM OPERATION	0	0	0
Interest (expense)/income			
INCOME BEFORE INCOME TAXES	0	0	0
Income Tax Expense			
NET INCOME	0	0	0

Example no.2: Profit and Loss statement, A simplified version

A social enterprise produces in the first year of work 9,000 t-shirts, each one worth 5 Euros. To produce these t-shirts, the enterprise uses:

- Cotton material reused: 10,000 €
- Other raw materials: 5,000 €
- Energy and fuel for production: 1,000 €
- For the production of t-shirts, the company buys sewing machines worth 9,000 €, with an annual depreciation of 900 €. The acquisition of sewing machines is covered by shareholders' equity. Employee salaries are 21600 € per year.
- For the headquarters in which it operates, the company pays an annual rent of 6000 €. The energy for lighting and heating the office costs 1200 € per year. The company also has other administrative expenses of 300 € per year.
- The company benefits from an annual donation of 1200 €. Calculate the company's profit.

Example no.1: Profit and Loss statement, a simplified version

Revenues	Amount	Costs	Amount
Revenues - total	46200	Costs of sales - total	46000
Sales	45000	Materials	15000
Memberships	0	Wages	21600
		Depreciations	900
Donations	1200	Factory heat, light and power for production	1000
Other revenues	0	Other costs of sales	0
		Administrative costs	7500
Net Profit/Loss (Revenues-Costs)	200		

The Cash Flow

- Cash flow is the money that is moving (flowing) in and out of your business over a specific period of time.
- Cash is coming in from clients who are buying your products or services and it is going out of your business in the form of payments for expenses (accounts payable).
- The cash flow from operating activities is cash from business operations.
- The Cash flow from investments results from buying or selling assets used in the business.
- The cash flow from financing results from the financial activity (selling shares, paying dividends).
- The cash flow shows the liquidity ...

Example no. 2: The liquidity plan

The company EMY creates a subsidiary in Romania which will start its activity at the beginning of January. It had to buy a 30,000 € machine partially financed by a bank loan of 20,000 € refundable at 2,000 € every 15 July and 15 January of each year right away for 5 years. The financial expenses payable semi-annually are as follows:

Year 1 (€)		Year 2(€)		Year 3(€)		Year 4(€)		Year 5(€)	
June	Dec.	June	Dec.	June	Dec.	June	Dec.	June	Dec.
1000	900	800	700	600	500	400	300	200	100

Profits are exempt from tax. The turnover will be 12,000 € per month. One month of finished product stock will have to be constituted. Customers pay at 90 days.

The company, which intends to have a month of purchases in advance, decides to buy raw materials for two months in January. The normal monthly requirement is 4,000 €. The furnisher provides a credit of 90 days. Other fees are:

- Personnel costs, amounting to 4,000 € per month
 - Transportation, packing and other costs, amounting to 2000 € per month and are paid at 30 days.
- These fees appear as of January 1st.

Establish a monthly and annual liquidity plan.

What is the cash requirement of the subsidiary at the end of each month of the first year?

Example no. 2: The liquidity plan

Year	1 (th. Euro)												Total
Period	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec	Y1
Operating revenue	0	0	0	0	12	12	12	12	12	12	12	12	96
Operating Expenses	4	6	6	14	10	10	10	10	10	10	10	10	110
Raw materials	0	0	0	8	4	4	4	4	4	4	4	4	40
Salaries (Personnel costs)	4	4	4	4	4	4	4	4	4	4	4	4	48
Transportation	0	2	2	2	2	2	2	2	2	2	2	2	22
Cash flow from operating activities	-4	-6	-6	-14	2	2	2	2	2	2	2	2	-14
Investment	-30	0	0	0	0	0	0	0	0	0	0	0	-30
Assets disposal	0	0	0	0	0	0	0	0	0	0	0	0	0
Cash flow before taxes	-34	-6	-6	-14	2	2	2	2	2	2	2	2	-44
Cash Flow for creditors	-18	0	0	0	0	1	2	0	0	0	0	0,9	-14,1
Loan	-18						2						-16
Interest						1						0,9	1,9
Cash flow for shareholders	-16	-6	-6	-14	2	1	0	2	2	2	2	1,1	-29,9

The Balance Sheet

- The balance sheet shows what the company owns and what it owes at a specific points in time.
- A balance sheet is organized into two sections. The first section lists all of the company's assets. The second sections lists the firm's liabilities and owner's equity.
- According to the accounting equation: $\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$.

The Balance Sheet

ASSETS	Value (Euro)	LIABILITIES	Value (Euro)
Cash		Accounts payable	
Accounts receivable		Short-term loans	
Inventory		Current portion of long-term debt	
Temporary investment (short-term investments)		Interest and dividends payable	
Prepaid expenses		Taxes, rent, utilities payable	
Total current assets	0	Accrued payroll	
Long-term investments		Total current liabilities	0
Land		Mortgage	
Intangible assets		Long-term debt (interest and principal)	
Buildings, Plant and equipment (less accumulated depreciation)		Other long-term liabilities	
Furniture and fixtures (less accumulated depreciation)		Total long-term liabilities	0
Total fixed assets	0	Capital stock (paid-in capital)	
Total assets	0	Retained earnings (current year included)	
		Total shareholders equity	0
		Total liabilities and equity	0

The Balance Sheet: example

	2020
Assets (Euro)	Amount
Cash	6000
Inventory	0
Prepaid expenses	5000
Furniture & Fixtures	16000
Total Assets	27000
Liabilities & Owner's Equity (Euro)	
Current Liabilities	2000
Loans & Long-Term Liabilities	0
Owner's equity (Capital stock)	25000
Total Liabilities & Owner's Equity	27000

Thank you!