



Erasmus+

How money works in business?

Professor Monica Dudian, PhD

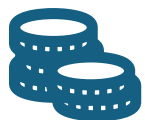
Agenda



The Income
Statement



The Balance
Sheet



The Cash Flow

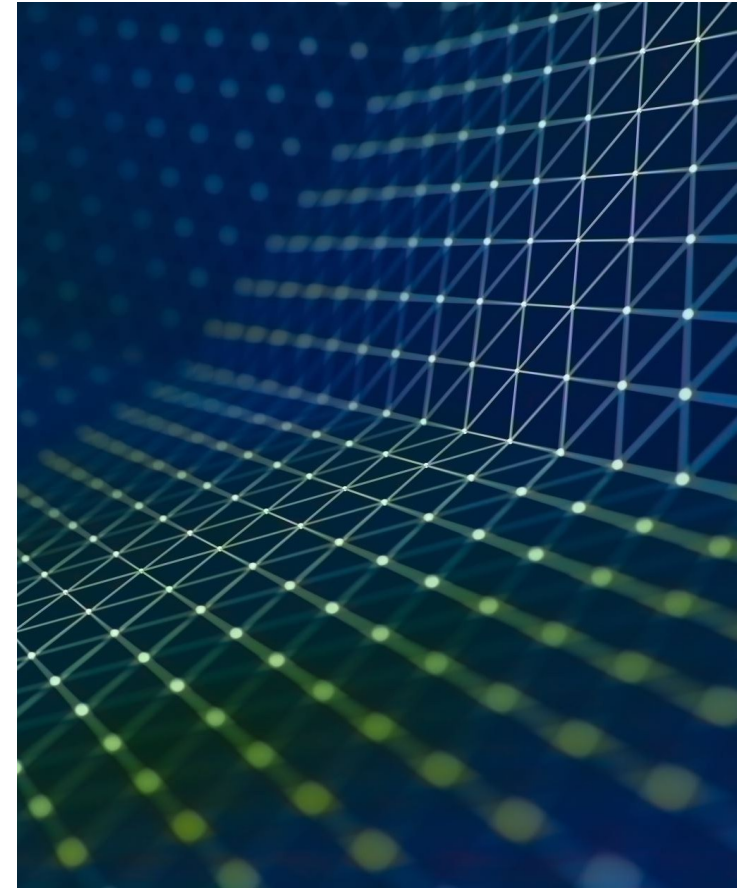


The main sources of financing available to SMEs

Internal financing: the owner's personal savings, reinvested profits and funds generated from the business's daily operations. Internal financing is attractive because it does not create debt and does not require the owner to give up control of the business. However, it is usually limited, especially for new firms or businesses that are growing quickly.

Bank financing: loans, credit lines, overdrafts, or leasing products from commercial banks. Bank loans are often used for investment projects, such as buying machinery, vehicles, or property. Credit lines and overdrafts are useful for covering short-term liquidity needs, such as paying suppliers before customers pay their invoices. Leasing allows firms to use equipment without paying the full purchase price immediately. The main disadvantage of bank financing is that banks usually require collateral, a good credit history, and proof of stable income, which can be difficult for small or new firms.

Public financing, especially through grants, subsidies, guarantees, and government-supported programs.

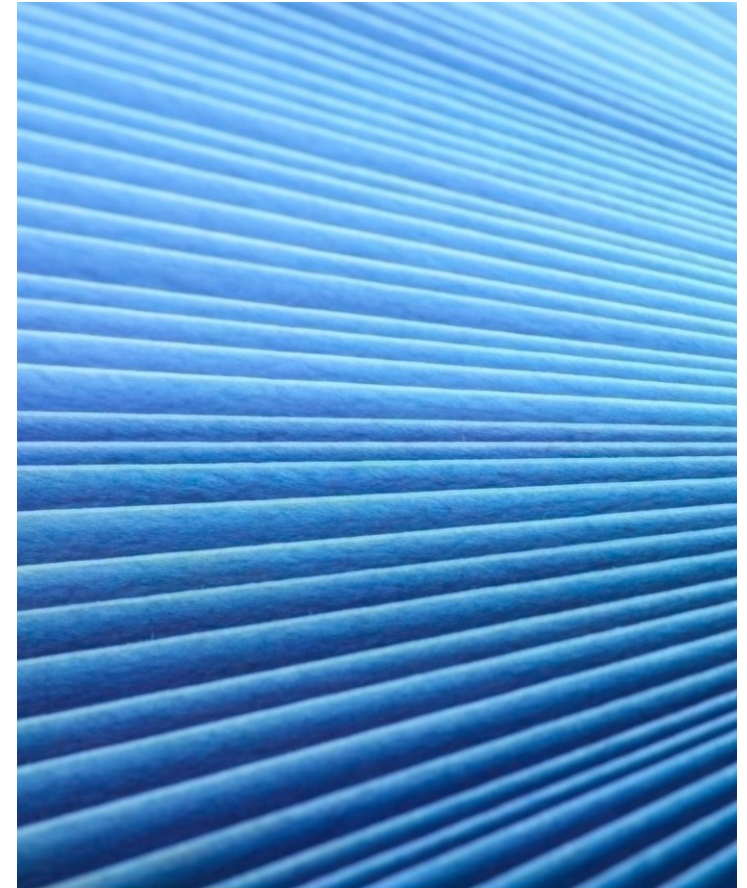


The main sources of financing available to SMEs

Equity financing, which means attracting investors who provide capital in exchange for ownership shares. This may include business angels, venture capital funds, private equity investors, or strategic partners. The advantage is that the business does not have to make regular debt repayments. The disadvantage is that the owner gives up part of the company and may share decision-making power with investors.

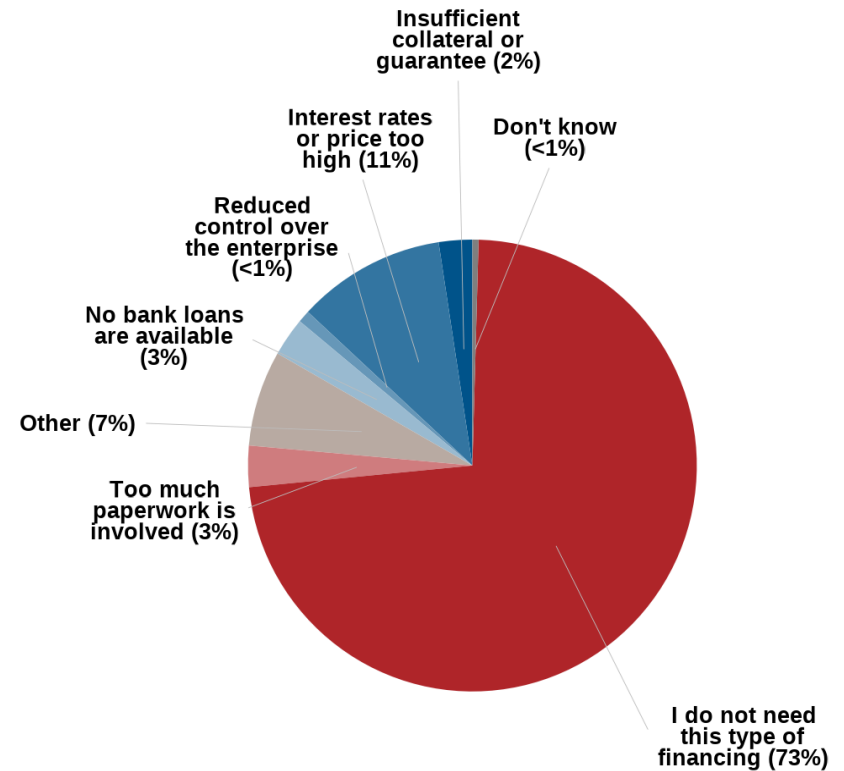
Alternative financing: crowdfunding platforms, peer-to-peer lending platforms (connect borrowers directly with investors), factoring. These methods can be faster and more flexible than traditional bank loans, although they may involve higher costs or platform fees.

Trade credit and supplier financing. Trade credit occurs when suppliers allow the business to buy goods or services and pay later. This is a practical and widely used form of short-term financing because it helps firms manage cash flow. Some SMEs may also negotiate advance payments from customers, especially for large orders or customized products.

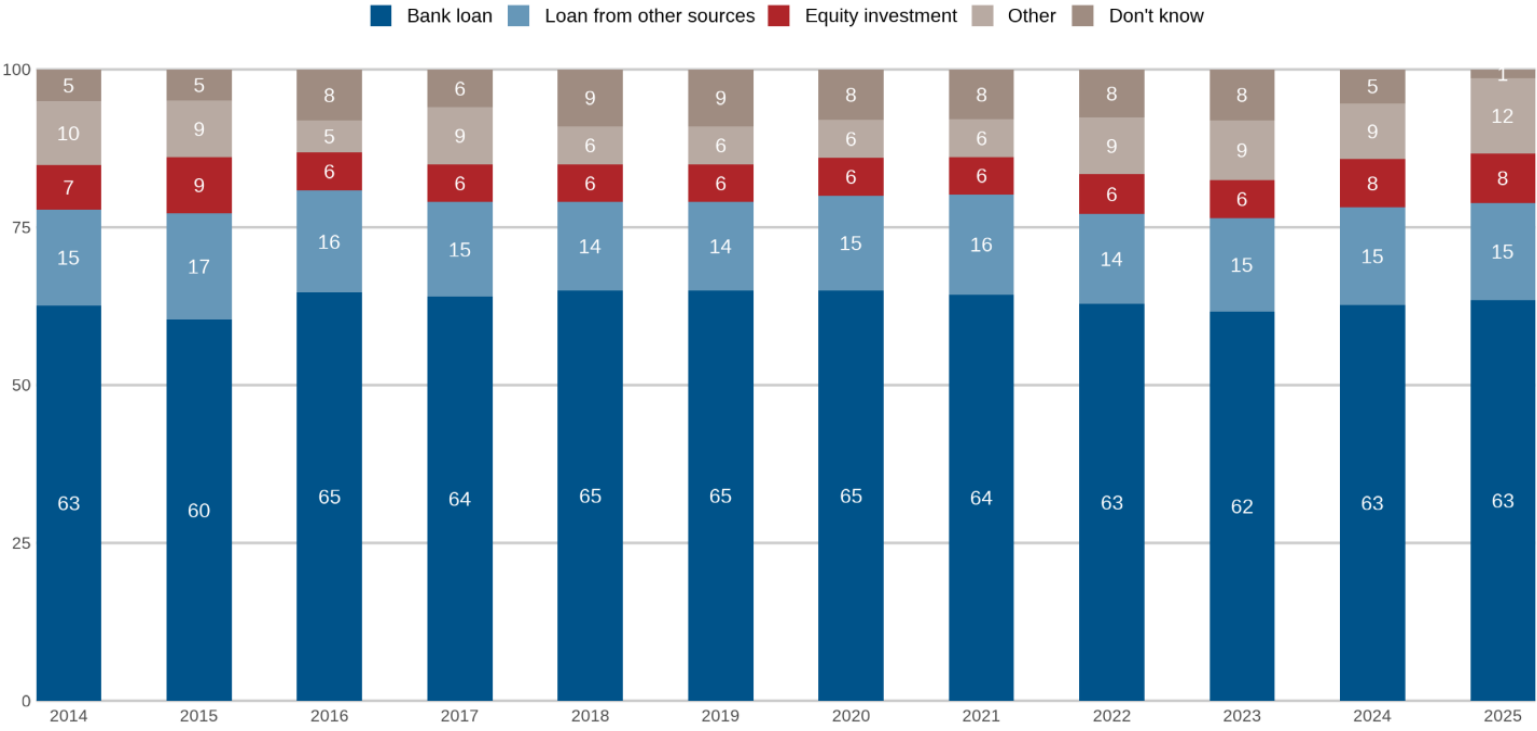


Why are bank loans not a suitable financing option for EU SMEs? (% - EU27)

EU, SAFE, 2025



Preferred financing sources for enterprise growth, 2025



EU, SAFE, 2025



The main questions related to the financial situation

What activities will you perform in generate income?

What kinds of equipment will you need?

How much labour and what type of skills?

What facilities or locations will you require to operate?

Why do we need accounting?

- Accounting is the total structure of records and procedures used to record, classify, and report information about a business's financial transactions.
- Accurate financial statements are the only way you can know how well your business is doing. Financial reports help you monitor the situation of your business, make business decisions and intervene to prevent crisis situations.
- The financial statements are also key documents for creditors and other potential investors.
- Many small business people serve as their own bookkeepers, at least in the beginning phase of their business.



The image shows a financial statement table with a magnifying glass focusing on a specific section. The table is divided into several sections: Net Sales, Cost of Sales, Operating Expenses, and Profit and Loss. The magnifying glass is positioned over the 'Operating Expenses' section, specifically highlighting the 'Selling' and 'General/Administrative' categories. The table includes columns for 'Amount', '% of Sales', and 'Year'. The 'Profit and Loss' section at the bottom shows monthly data from January to September, with columns for 'Budget - Actual' and 'Prior year - Actual'.




Net Sales	1,070,000	1	800,000	1,920,000
Cost of Sales				
Beginning inventory	540,000	1	45,000	
Plus goods purchased/manufactured	123,000	0	250,000	
Total goods available	200,000	0	295,000	
Less ending inventory	38,000	0	200,000	
Total cost of goods sold	20,000	0	95,000	
Gross profit (loss)	1,050,000	1	1,825,000	
Operating Expenses				
Selling				
Salaries and wages	122,000		32,000	
Commissions	112,000	0	22,000	
Advertising	335,000	0	37,000	
Depreciation	10,000	0		
Total selling expenses	680,000	1	15,000	
General/Administrative				
Salaries and wages	10,000	0		
Employee benefits	83,000			
Payroll taxes	70,000			
Insurance				
Rent				
Utilities				
Depreciation				



Key terms for the Income Statement

- **The income statement** is the financial statement that presents a summary of the company's financial activity over a certain period.
- The main components are Revenue, Costs of Goods Sold and Expenses, and Net Profit or Loss.
- **Revenue**, often referred to as sales, represents all money coming from sales (operating income) and other operations (non-operating income) such as selling assets the business no longer needs.
- **Costs of Goods Sold** represent money spent to purchase or make products or services a company plan to sell to its customers.
- **Expenses** are money spent to operate the company that is non directly related to the sale.
- **Net Profit or Loss** = Revenues – Costs of Goods Sold - Expenses

How is the money being spent?

		
<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>

Other common terms you find in the Financial Statements



Accounts payable tracks all outstanding bills from vendors, contractors, and any other entities from whom the company buys goods and services.



Accounts receivable tracks all customer sales that are made by store credit. Store credit refers to sales in which the customer is given credit directly by the store and the store needs to collect payment from the customer at a later date.



Depreciation that tracks the aging and use of assets. For example, if you own a computer, you know that each year you use the computer its value is reduced. Every major asset a business owns ages and needs to be replaced after a certain period.



Inventory tracks all products that will be sold to customers and goods that will be used in production.



Prepaid expenses are value that has already been paid for such as insurance or rent.



Accrued payroll comprises wages, bonuses, benefits earned and payable to the employees.

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 income statement: an example

- A family farm produces and sells wheat and corn annually. The income from the sale of wheat is 20,000 Euros per year, and those from the sale of corn are 10,000 Euros per year.
- In order to carry out this production, the farm buys seeds and fertilizers worth 5000 Euros, energy and fuel worth 3000 Euros and pays the landowners a rent of 500 Euros.
- Employee salaries are 9,600€ per year.
- For agricultural works, the farm buys a multifunctional machine worth 30,000 Euros, with an annual depreciation of 3,000 Euros. The acquisition of the machine is covered by shareholders' equity and by a long-term loan worth 5,000Euros. The interest is 200 Euros per year.
- The company benefits from an annual subvention of 1000 € from the government.
- Calculate the company's profit.



Income Statement (EURO)	
Farm Receipts: (Sales; Donations; Government Payments; Other Farm Income)	
Wheat	20,000
Corn	10,000
Government Payements	1,000
Total Farm Receipts	31,000
Farm Expenses: (Labor, Fertilizer; Chemicals; Seeds; Fuel; Miscellaneous, etc.)	
Seeds and Fertilizer	5,000
Energy and fuel	3,000
Land Rent	500
Salaries	9,600
Total Farm Expenses	18,100
Earnings Before Interest, Taxes, Depreciation and Amortization or EBITDA (Farm Receipts - Farm Expenses)	12,900
Less Interest Cost (Includes interest paid on all loans)	200
Plus Net Non-Farm Earnings (This is non-farm income minus non-farm expenses; other business income)	0
Less Depreciation	3,000
Less Family Living and Income Taxes (Owner draws; Living Expenses; Income Taxes)	0
Net Earnings or Net Income (EBITDA less interest cost plus net non-farm income, less depreciation, less family living)	9,700

The Balance Sheet

- The balance sheet shows what the company owns and what it owes at a specific points in time. It discloses the amounts of assets being used to make sales and profit, as well as its capital sources.
- A balance sheet is organized into two sections. The first section lists all of the company's assets. The second section lists the firm's liabilities and owner's equity.
- According to the accounting equation:
- $\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$



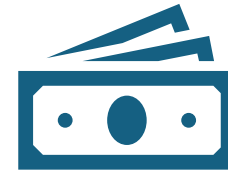
The Balance Sheet



Assets



It is about what the business owns.



Assets are items, such as equipment, cash supplies, inventory, receivables, buildings, and vehicles – that a business owns, and derives future use from.

Potential investors and stakeholders will want to know what resources a company has at its disposal.

The Balance Sheet

- Liabilities
- It is about what it owes
- A liability is a debt that a social enterprise has incurred with another party.
- For example, when it borrows money from an investor or purchases materials from other suppliers the business is required to make a future payment to satisfy that debt.



Key terms for the Balance Sheet



The Balance Sheet presents the situation of the company's financial position as a particular point in time. The name comes from the equality between the two main components of the balance sheet: assets on the one hand, and liabilities and equity on the other.



Assets are resources the company owns in order to run its business. Examples of assets are buildings, land, cash etc. We can have resources on short-term, less than 12 months, named **current assets** (cash, accounts receivables, inventory), or on long-term, named **fixed assets** (land, buildings, equipment). Resources that have no physical presence are named intangible assets, such as patents or copyrights.



Liabilities are all debt the company owes, such as loans and unpaid bills. **Current liabilities** includes debts the company must pay over the next 12 months (bills, interest, credit cards payable). Long-term liabilities includes debts the company must pay over a period longer than 12 months (such as long-term loans, mortgages).



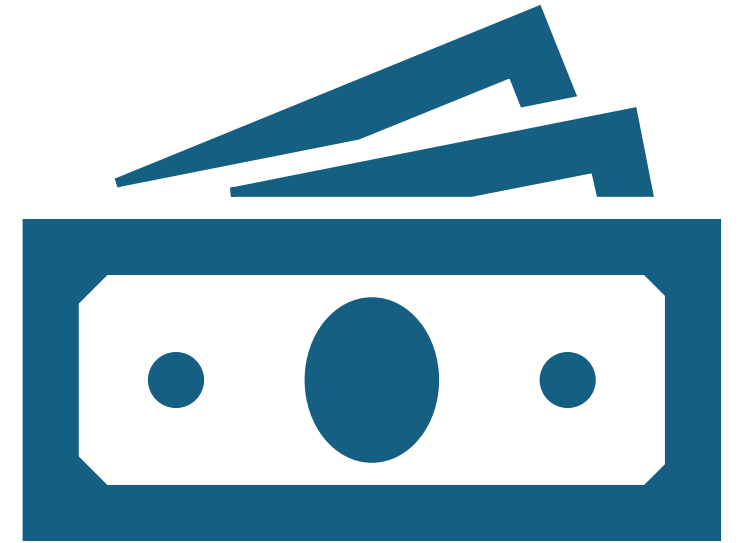
Equity represents the money invested in the company by its owners. For a small business with a single owner, the equity is shown in the Capital account. The Equity account also comprises the **Retained Earnings** tracking all company profits that have been reinvested in the company.

The Balance Sheet: an example

Assets	
<i>Current Assets:</i> (others include: Prepaid Expenses & Investment in Growing Crops; Market Livestock; Other Liquid Assets)	
Cash	5,000
Accounts Receivable	\$0
Feed, Seed & supplies	500
Crops for Resale	0
Total Current Assets	5,500
<i>Fixed Assets:</i> (Others include: Retirement Accounts; Real Estate; Other Term Assets)	
Equipment	27,000
Vehicles	0
Total Fixed Assets	27,000
Total Assets: (Current Assets + Fixed Assets)	32,500
Liabilities	
<i>Current Liabilities:</i> (Others include: Loans with Terms less than 1 year; Current portion of Term Liability Principle due within next 12 months)	
Accounts Payable	0
Accrued Expenses	800
Operating loans	0
Total Current Liabilities	800
<i>Term Liabilities:</i> (Balances should be less than the Principle due in the next 12 months that will be shown as Current Liability)	
Loans (term greater than 1 year)	5,000
Capital Leases	0
Total Long term Liabilities	5,000
Total Liabilities: (Current Liabilities + Term Liabilities)	5,800
Owner's Equity or Net Worth: (Total Assets - Total Liabilities)	26,700
Total Liabilities and Owner Equity: (Must Equal total assets)	32,500

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.



The Cash Flow: an example

- Let's take the example of the previous farm. Suppose that it obtains in full the income from the sale of wheat in August (20,000 Euros) and those from the sale of corn in November (10,000 Euros).
- It buys fertilizers and seeds in January (5000 Euros). He pays for fuel four times a year, in April, June, September and December, worth 750 Euros. Salaries are paid monthly, amounting to 800 Euros. The rent for the land is paid in December, in the amount of 500 Euro. Also in December, the subsidy of 1000 Euro is collected from the government.
- The agricultural equipment is bought in January, when the loan is also accessed. But the equipment is paid in February. The loan is refundable at 500 € every 15 July and 15 January of each year right away for 5 years. The interest is paid once a year in June.



The Cash Flow: an example

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec	Y1
Operating Revenue	0	0	0	0	0	0	0	20000	0	0	10000	1000	31000
Sales	0	0	0	0	0	0	0	20000	0	0	10000		30000
Subsidy	0	0	0	0	0	0	0	0	0	0	0	1000	1000
Operating expenses	5800	800	800	1550	800	1550	800	800	1550	800	800	2050	18100
Seeds and fertilizers	5000	0	0	0	0	0	0	0	0	0	0	0	5000
Energy and Fuel	0	0	0	750	0	750	0	0	750	0	0	750	3000
Rent	0	0	0	0	0	0	0	0	0	0	0	500	500
Salaries	800	800	800	800	800	800	800	800	800	800	800	800	9600
Cash from operating activities	-5800	-800	-800	-1550	-800	-1550	-800	19200	-1550	-800	9200	-1050	12900
Investment	0	-30000	0	0	0	0	0	0	0	0	0	0	-30000
Asset disposal	0	0	0	0	0	0	0	0	0	0	0	0	0
Cash Flow before taxes	-5800	-30800	-800	-1550	-800	-1550	-800	19200	-1550	-800	9200	-1050	-17100
Cash Flow from creditors	-4500	0	0	0	0	200	500	0	0	0	0	0	-3800
Loan	-4500	0	0	0	0	0	500	0	0	0	0	0	-4000
Interest	0	0	0	0	0	200	0	0	0	0	0	0	200
Cash Flow from owner	-1300	-30800	-800	-1550	-800	-1750	-1300	19200	-1550	-800	9200	-1050	-13300



Thank You!

