Financial Start up

[Enter name of Student]

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**Sources and Uses of Capital**

 Finance is considered as the lifeblood for any business, so it is important for us to pay ample attention to this aspect as well. Financial statements include income statement, balance sheet and a statement of cash flows. Estimated financial statements and related financial ratios for the first three years of operations will be shown in the last part of this document. In this section, we will analyse and interpret the various components of financial statements and financial ratios.

Start-ups are business projects which have high risks as well as high growth and require a significant amount of money in the form of outside financing. Businesses can have debt as their source of financing as well as a combination of debt and equity financing. Debt financing can be complicated in some scenarios, but mostly they will contain characteristics which are common and straight forward. The lenders will not be allowed to tell entrepreneurs how to run their business, and if a business fails to pay debt payment on time, it may go into bankruptcy. The biggest benefit of debt financing is that when the debt is fully paid, relationship ends and lenders cannot direct the way business will be run by owners. The current business is a small set up so they will want to keep full control in their own hands. Business has to make sure that it pays the periodic debt payment on time so that there is no danger of bankruptcy, and at the same time improving the credit rating of the business and loans will be easily available to this business.

 Start-ups may not be able to have enough cash to pay their debts on a regular basis, and entrepreneurs may want to reinvest profits to their business for growth rather than paying debt. They must realize that missing debt payments will have serious implications for their businesses. When a start-up is not able to pay loan payment, it immediately goes into default but inability to pay current portion of debt is one of many ways that a new business can be hindered by loan. There are certain conditions which have to be met when a loan is outstanding. Financial restrictions include the ability to maintain a certain level of assets or not to take more debt as long as current debt is not repaid. The entrepreneurs may be asked to provide all financial statements to the bank on a regular basis so that bank can ascertain that no financial covenant is violated. Some bounds by bank may also be imposed on operating activities which may include that company money may not be used for specific purposes. Banks seem to be monitoring businesses all the time until loan is fully paid. There are important non-bank lenders for start-ups who provide loans on much easier terms and conditions. The current business may face many issues if there it opts for debt financing, and the biggest issue will be the fact that small businesses may not get loans easily without a collateral. For the current business, it will be particularly difficult to obtain a loan because of its small size (Oranburg, 2016). Being small in size will mean that only debt will be suitable for this business. We will use the amount of loan to rent out premises for our business. There will be some one-time costs whereas some expenses have to be incurred regularly over a period of time. We know our customers so we will be able to generate some amount of revenues immediately which is very important because most businesses fail because they do not have any cash in hand after some operations. In Brookside area, a small business may require $ 80000 to start which will be provided half in loan and half from our savings. Once the place is finalized, we will have to renovate it according to our needs. Since we are starting a small business, no salaries will have to be paid by us. We will advertise for our business in the local area with help of flyers. The use of debt and equity as a mixture will allow the business to benefit from the advantages of both these sources of finance. When the loan will be fully paid, our business may be able to generate much cash to finance our operations.

**Cash flow Projections**

A cash flow statement shows the inflows and outflows of cash transactions undertaken by a business. There are three major activities shown in a cash flow statement namely operating, investing and financing activities. For a business just starting, a statement of cash flow will include operating activities only along with the financing activities but due to the simplistic nature of our business, our cash flow statement will only show operating activities. Operating activities include revenues from operations in the form of inflow of cash whereas expenses are shown as outflows of cash. It is important for a business to maintain a positive net cash flow from operations so that financers remain satisfied that business is going in the right direction. Without a satisfactory cash flow statement, it is hard for any business to be financed by any outside party.

|  |  |  |  |
| --- | --- | --- | --- |
|  | Year 1 | Year 2 | Year 3 |
| Opening Balance  | 0 | 38900 | 44500 |
| Sources of Cash |  |  |  |
|  Cash Sales | $ 50000 | $ 60000 | $ 72000 |
|  Bank  | $ 40000 |  |  |
| Uses of Cash |  |  |  |
| Rent | $6000 | $ 6600 | $ 7260 |
| Utilities  | $ 7000 | 7200 | 7500 |
| Ingredients | $ 25000 | $ 27500 | $ 30000 |
| Insurance  | $ 800 | $ 800 | $ 800 |
| Taxes | $ 300 | $ 300 | $ 300 |
| Interest | $ 4000 | $ 4000 | $ 4000 |
| Principal | $ 8000 | $8000 | $ 8000 |

 Above is the cash flow projections for first three years of our business showing that the main source of cash inflow will be sales to our customers. Bank loan will be available as a source of cash but it will be available only one-time to us. Major outflows will comprise of rent, utilities and ingredients. The projections include interest and principal payments on loan taken up from bank. It is important that our business should be able to maintain a reasonable level of cash in hand at any given point in time, which means that any increase in expenses can be easily handled by us. Similarly, if there is an increase in demand for our product, we will be able to cover the increased cost of ingredients. Insurance is necessary to cover us against any unplanned hazard. Problems might arise when there is no bank loan available as cash inflow to business, and it has to rely on its revenues solely. In the second and third years, our business will make sure that expenses are controlled. There are some compulsory expenses which have to be incurred by the business even if it is not operating, in case of our business, loan and principal are examples of such expenses. Other expenses are discretionary at the will of business, e.g. ingredients or utilities. We will try and minimize the discretionary expenses so that overall cost of running business remains low.

**Projected Balance Sheet**

 A balance sheet is also called a statement of financial position because it shows position of a business at a given point in time. It includes assets and liabilities which represent the resources and obligations of a business towards others. Resources are bought with the help of either equity or debt finances. These become the resources of our business, whereas some obligations will also arise in the form of liabilities raised during the process. Assets can be current or fixed depending upon their term of usage or liquidity. Cash will be considered a current asset, whereas a building will be considered a non-current or fixed asset. In the balance sheet of our business, typical current assets will be inventories and receivables, whereas liabilities will include payables to suppliers and loan that was obtained at the start of business. Balance sheet will also include an equity section that will show the capital structure of business.

|  |  |  |  |
| --- | --- | --- | --- |
| Current Assets | Year 1  | Year 2 | Year 3  |
|  Cash in hand | 10000 | 12000 | 12500 |
|  Inventory | 3000 | 3000 | 3000 |
| **Total Current Assets** | **13000** | **15000** | **15500** |
| Non-current Assets |  |  |  |
|  Equipment | 4000 | 3500 | 2500 |
|  Van | 32000 | 28800 | 25600 |
| **Total**  | **36000** | **32300** | **28600** |
| **Total Assets** | **49000** | **47300** | **43600** |
| **Current Liabilities** |  |  |  |
|  Accounts payable | 5000 | 4500 | 4200 |
|  Interest payable | 4000 | 4000 | 4000 |
| Long Term Liab. |  |  |  |
|  Loan | 40000 | 38800 | 35400 |
| **Total** | **49000** | **47300** | **43600** |

The above table shows balance sheet of our business for first three years of running. The major point of concern for our business is the decrease in total assets, as shown by estimated balance sheets. This decrease is mainly due to depreciation on van. Our business will grow in terms of current assets over a period of three years. Inventory costs will decrease over a longer period of time because we will be able to manage it through just in time system. It will constitute of the fruits used to make smoothie and will be perishable in nature. Once we are established in the market, we will be able to purchase and consume fruits on daily basis. Accounts payables represent amount that business owes to its suppliers at any given point in time. This amount will decrease with the passage of time as the business will become self-sufficient in terms of purchases on cash. In order to survive in the long run, we will make sure that our assets increase over time. The assets show resources of business whereas liabilities and capital shows the sources of finance.

**Projected income Statement**

 Income statement is the starting point for financial reporting and analysis because it shows the effects of routine operations of business. Sales form first item in income statement, which are revenues to business. Expenses are categorised as either direct or indirect on the bases of possibility of direct identification. Cost of goods sold in our business; utilities will be direct expenses because they are directly identifiable with sales. Indirect expenditures include the likes of advertising and other similar expenditures. In the start, sales will be low, and business will go into a loss for at least a couple of years. In these years, it will be necessary for our business to keep the expenses low and have a sustained increase in sales revenue. Indirect expenses are those which are not directly related to sales and business can sell its products without incurring these expenses but not for a long period of time. Classification of direct and indirect expenses is very important for the business because it will have an effect on efficient working in terms of gross and net profits.

|  |  |  |  |
| --- | --- | --- | --- |
|  | Year 1  | Year 2 | Year 3  |
| Sales | 50000 | 60000 | 72000 |
| Cost of Goods Sold | (25000) | (30000) | (36000) |
| **Gross Profit** | **25000** | **30000** | **36000** |
| Rent | 6000 | 6600 | 7260 |
| Insurance | 800 | 800 | 800 |
| Taxes | 300 | 300 | 300 |
| Interest | 4000 | 4000 | 4000 |
| **Net profit**  | **13900** | **18300** | **17540** |

 Sales will be the major source of revenue for our business, and we expect it to grow steadily over the three year period under consideration. Cost of goods sold includes direct expenses related to operations of the business and primarily include cost of material. Business has shown considerable potential for profit over its first three years of operations.

**Breakeven Analysis**

 Break even analysis refers to a stage of operations where revenues equal expenses and there is no profit for a business. This procedure can be very helpful in evaluating new venture like ours. Success takes considerable time to be achieved and success in a business means that expenses are covered by revenues and there is a profit earned. The price and volume quantities are used to analyse the break even for any business which informs the business about time it will have to bear losses. Short term bench marking can best be achieved with the help of break-even analysis. We assume that our fixed costs are $ 5000 and variable cost per unit is $ 1.5 with price set at $ 4 per unit. This data shows that company will need to sell 2000 units of its product to reach breakeven point. The nature of our business is such that it will reach breakeven point very quickly.

**Ratios**

Current ratio has been one of the oldest ratios in the financial analysis of any company and is calculated to see short term liquidity of a company (Horrigon, 1968). It is calculated by dividing current assets by current liabilities. An acceptable current ratio is 2 to 1, meaning that company will have double the assets as compared to liabilities. For all three years, our business will have a very high current ratio, meaning that we will have almost 5 times more current assets as compared to current liabilities. This also shows the nature of our business that it does not contain any considerable current liabilities, and it has a high value of current assets. Another important ratio that is associated with our operations is days outstanding for payables. This will show the number of days taken by us to clear our payables. The payable turnover ratio reveals that our business will be able to pay out trade creditors about 100 times in a year which makes it 3.65 days to pay off creditors. This will show a positive image of our business and will help us in taking any loans in the future.

Gross profit margin is helpful in examining gross profit as a percentage of sales (Lesakova, 2007). From the income statement, we see that there is a 50% margin for gross profit over sales. This percentage may seem higher for some people, but it is achievable because of the nature of our product.

**Risks and assumptions**

 The first risk is that we may not get the number of customers anticipated in the first year or even in the second year. There may be certain reasons for this to happen, but the most important one is that the marketing campaign may not be strong enough to attract customers. Another risk is that the prices of inputs are raised and we may fall short on ready cash. In this case, we will have no option other than to close our business. Interest rate increase may also affect our business. A critical assumption is that our business will be a going concern which means that all financial statements must be made keeping in view the future of a business. Without this assumption, we may not be able to attract any financing facility for our business.

# **References**

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