UNIT 15

Business



15.1 Types of Businesses

When it comes to starting a business, there are various structures to consider, each with its own advantages and disadvantages. Let's explore three common types of businesses: sole proprietorships, partnerships, and corporations.

1 Sole Proprietorships

Pros

- Simplicity: A sole proprietorships is usually the easiest and most straightforward type of business to set up. It involves a single owner who has full control over decision-making.
- Direct Profits: The owner receives all the profits generated by the business.
- Minimal Regulations: Sole proprietorships usually have fewer legal requirements and regulations to follow.

Cons

- Limited Resources: Funding and resources are limited to the owner's personal savings or loans.
- Unlimited Liability: The owner is personally responsible for all the business's debts and liabilities.
- Limited Expertise: The owner may lack expertise in certain areas required for the business's growth.

2 Partnerships

Pros

- Shared Responsibilities: Partners can share the workload, skills, and resources, allowing for better decision-making.
- Diverse Expertise: Partners bring different skills and expertise to the table, which can enhance the business's overall operations.

- Shared Financial Burden: Partners can pool their resources and investments for business growth.

Cons

- Conflict Potential: Disagreements between partners can arise, affecting decision-making and potentially harming the business.
- Shared Profits: Profits are divided among partners, potentially leading to less individual earnings.
- Joint Liability: Each partner is liable for the actions and debts of the other partners.

3 Corporations

Pros

- Limited Liability: Shareholders' personal assets are protected from business liabilities.
- Access to Capital: Corporations can raise funds by issuing stocks to investors.
- Professional Management: Corporations can attract professional managers to run the business efficiently.

Cons

- Complex Setup: Corporations involve complex legal and administrative procedures for formation and operation.
- Double Taxation: Corporations are subject to taxation at both the corporate level and the individual shareholder level.
- Regulatory Requirements: Corporations have stricter regulatory and reporting obligations.

Remember, the choice of business structure should align with your goals, resources, and risk tolerance. Each type offers different benefits and challenges, so it's essential to carefully consider your options before launching your entrepreneurial journey.

15.2 Financial Documents and Business Expenses

The financial statements of a company record important financial data on every aspect of a business's activities. Companies use the balance sheet, income statement and cash flow statement to manage the operations of their business. The income statement provides an overview of the company's financial performance, showcasing its revenue, expenses, and resulting net income (profit) for a specific period.

a. The Income Statement

Here's an example of an income statement:

Income Statement for XYZ Company For the Year Ended December 31, 20XX

Revenue

Sales Revenue $500,000

Other Revenue $10,000

Total Revenue $510,000

Expenses

Cost of Goods Sold $250,000

Operating Expenses

- Salaries and Wages $100,000
- Rent $25,000
- Utilities $10,000
- Advertising $15,000
- Depreciation $20,000
- Other Expenses $5,000

Total Operating Expenses: $175,000

Interest Expense $5,000

Income Tax Expense $50,000

Net Income: (Profit) $30,000

In the income statement above, the various components are as follows:

- **Revenue:** This section represents the company's income generated from sales and other sources. In this example, sales revenue is $500,000, and other revenue (such as interest income or rental income) is $10,000. The total revenue is calculated as the sum of sales revenue and other revenue, which equals $510,000.
- **Expenses:** This section lists the various expenses incurred by the company during the year. Cost of Goods Sold (COGS) represents the expenses directly related to producing the goods or services sold, which is $250,000 in this case. Operating expenses include salaries and wages, rent, utilities, advertising, depreciation, and other expenses, totaling $175,000. Interest expense represents the interest paid on loans or credit, which amounts to $5,000. Income tax expense denotes the taxes owed on the company's taxable income and is $50,000 in this example.
- **Net Income (Profit):** Net income is the final line item on the income statement and represents the company's profit after deducting all expenses from the revenue. It is calculated by subtracting the total expenses (including cost of goods sold, operating expenses, interest expense, and income tax expense) from the total revenue. In this case, the net income (profit) is $30,000.

b. The Balance Sheet

The balance sheet provides a snapshot of a company's financial position at a specific point in time, showcasing its assets, liabilities, and shareholders' equity.

Here's an example of a balance sheet:

Balance Sheet of XYZ Company As of December 31, 20XX

Assets: Current Assets

- Cash and Cash Equivalents $50,000
- Accounts Receivable $40,000
- Inventory $60,000
- Prepaid Expenses $5,000 Total Current Assets $155,000

Fixed Assets

- Property, Plant, and Equipment $200,000
- Less: Accumulated Depreciation ($50,000) Net Fixed Assets $150,000

Total Assets $305,000

Liabilities and Shareholders' Equity: Liabilities: Current Liabilities

- Accounts Payable $25,000
- Short-Term Loans $15,000
- Accrued Expenses $10,000

Total Current Liabilities $50,000

Long-Term Liabilities

- Long-Term Loans $100,000

Total Liabilities $150,000

Shareholders' Equity

- Common Stock $100,000
- Retained Earnings $55,000

Total Shareholders' Equity $155,000

Total Liabilities and Shareholders' Equity: $305,000

In the balance sheet above, the various components are as follows:

- **Assets:** This section represents what the company owns or has a claim to. It is divided into current assets and fixed assets. Current assets include cash and cash equivalents, accounts receivable, inventory, and prepaid expenses, totaling $155,000. Fixed assets include property, plant, and equipment, with a net value of $150,000 (after deducting accumulated depreciation).
- **Liabilities:** This section represents what the company owes to others. It is divided into current liabilities and long-term liabilities. Current liabilities include accounts payable, short-term loans, and accrued expenses, totaling $50,000. Long-term liabilities represent long-term loans amounting to $100,000.
- **Shareholders' Equity:** This section represents the owners' claims to the company's assets. It includes common stock and retained earnings. Common stock represents the amount invested by shareholders, which is $100,000. Retained earnings represent the accumulated profits of the company, totaling $55,000.
- **Total Liabilities and Shareholders' Equity:** This is the sum of the liabilities and shareholders' equity sections and represents the total value of the company's financing, which in this case is $305,000.

c. The Cash Flow Statement

The cash flow statement provides an overview of the company's cash flows from operating, investing and financing activities. A cash flow statement typically includes three main components:

1. Operating activities
2. Investing activities
3. Financial activities

Here is an example of a Cash Flow Statement:

XYZ Company
Cash Flow Statement
For the Year Ended December 31, 2022

Operating Activities

Net Income: $100,000
Adjustments for non-cash items:
Depreciation Expenses: $20,000
Loss on Sale of Equipment: $5,000
Changes in working capital:
Increase in Accounts Receivable: ($15,000)
Decrease in Inventory: $10,000
Increase in Accounts Payable: $8,000
Net Cash Provided by Operating Activities: $118,000

Investing Activities

Purchase of Equipment: ($50,000)
Sale of Marketable Securities: $30,000
Net Cash Used in Investing Activities: ($20,000)

Financing Activities

Proceeds from Issuance of Common Stock: $40,000
Payment of Dividends: ($20,000)
Net Cash Provided by Financing Activities: $20,000
Net Increase in Cash: $118,000 - $20,000 + $20,000 = $118,000
Cash in Beginning of Year: $50,000
Cash at End of Year: $50,000 + $118,000 = $168,000

Now try solving these questions as they relate to typical items found in business financial documents.

Cost of Goods Sold (COGS)

Use the following formula to calculate the COGS.

Beginning inventory + purchases of inventory – ending inventory = COGS

1 A retail store has the following information for a particular month:

- Beginning inventory: $10,000
- Purchases during the month: $5,000
- Ending inventory: $8,000

Calculate the Cost of Goods Sold (COGS) for the month.

2 A clothing store purchased $40,000 worth of inventory at the beginning of the year. During the year, they made additional purchases totaling $20,000. The ending inventory was $15,000. Calculate the cost of goods sold for the clothing store.

3 A manufacturing company had raw material inventory worth $30,000 at the beginning of the year. They purchased additional raw materials worth $50,000 during the year. The ending raw material inventory was $25,000. Calculate the cost of goods sold for the manufacturing company.

4 A restaurant purchased food and beverages worth $15,000 at the beginning of the month. Throughout the month, they made additional purchases totaling $8,000. The ending inventory of food and beverages was $6,000. Calculate the cost of goods sold for the restaurant.

5 An electronics store had inventory worth $60,000 at the beginning of the quarter. They made additional purchases of electronics products worth $25,000 during the quarter. The ending inventory was $40,000. Calculate the cost of goods sold for the electronics store.

6 A bakery purchased baking ingredients worth $10,000 at the beginning of the year. They made additional purchases

of ingredients totaling $5,000 during the year. The ending inventory of baking ingredients was $8,000. Calculate the cost of goods sold for the bakery.

7 A bookstore had a beginning inventory of $10,000. During the year, they made purchases totaling $20,000. The ending inventory was valued at $8,000. Calculate the cost of goods sold for the bookstore.

8 A grocery store had a beginning inventory of $50,000. They made additional purchases totaling $30,000 throughout the month. The ending inventory was valued at $40,000. Calculate the cost of goods sold for the grocery store.

Gross Profit Margin

Use the following formula to calculate gross profit margin.

$$\frac{(Sales - COGS)}{Sales} \times 100$$

1 A retailer has total sales of $800,000 and the cost of goods sold is $600,000. Calculate the gross profit margin for the retailer.

2 A software company has total revenue of $1,200,000 and the cost of sales is $800,000. Calculate the gross profit margin for the software company.

3 A restaurant has total food and beverage sales of $400,000 and the cost of goods sold is $200,000. Calculate the gross profit margin for the restaurant.

4 A manufacturing company has total revenue of $2,000,000 and the cost of goods manufactured is $1,200,000. Calculate the gross profit margin for the manufacturing company.

5 A consulting firm has total sales of $300,000 and the direct costs related to providing services amount to $100,000. Calculate the gross profit margin for the consulting firm.

6 A grocery store has total sales of $1,000,000 and the cost of goods sold is $700,000. Calculate the gross profit margin for the grocery store.

Net Income

Use the following formula to calculate net income.

Revenue – COGS – Expenses

1 A small retail business had total revenues of $50,000 in a year. The cost of goods sold was $25,000, and operating expenses were $12,000. Calculate the net income for the business.

2 An online consulting firm generated total sales of $100,000 in a year. The cost of services provided was $35,000, and the company incurred operating expenses of $20,000. Calculate the net income for the consulting firm.

3 A manufacturing company had total revenue of $500,000 in a year. The cost of goods manufactured was $250,000, and operating expenses were $150,000. The company also received a non-operating income of $25,000. Calculate the net income for the manufacturing company.

4 A restaurant recorded total sales of $200,000 in a year. The cost of food and beverages sold was $80,000, and operating expenses amounted to $60,000. The restaurant also received a non-operating expense of $5,000. Calculate the net income for the restaurant.

5 A software company generated total revenue of $1,000,000 in a year. The cost of software development was $500,000, and operating expenses were $300,000. The company also received interest income of $10,000. Calculate the net income for the software company.

6 A company has total revenue of $500,000, cost of goods sold of $300,000, and expenses of $150,000. Calculate the net income for the company.

7 A retail store has total revenue of $800,000, cost of goods sold of $600,000, and expenses of $200,000. Calculate the net income for the retail store.

8 A consulting firm has total revenue of $1,200,000, cost of goods sold of $0, and expenses of $800,000. Calculate the net income for the consulting firm.

9 A restaurant has total revenue of $400,000, cost of goods sold of $150,000, and expenses of $200,000. Calculate the net income for the restaurant.

10 A manufacturing company has total revenue of $2,000,000, cost of goods sold of $1,200,000, and expenses of $820,000. Calculate the net income for the manufacturing company.

11 A small business has total revenue of $300,000, cost of goods sold of $100,000, and expenses of $250,000. Calculate the net income for the small business.

12 An e-commerce store has total revenue of $1,000,000, cost of goods sold of $700,000, and expenses of $400,000. Calculate the net income for the e-commerce store.

Break-Even Point

Understanding your break even point allows you to know how many sales you need to make to cover your costs or make a profit. Any sales above the break-even point represent profit.

Use the following formula to calculate your break-even point.

Fixed costs/(*sales price per unit – variable cost per unit*)

1 A company has fixed costs of $50,000, a sales price per unit of $10, and a variable cost per unit of $6. Calculate the break-even point for the company.

2 A retail store has fixed costs of $100,000, a sales price per unit of $50, and a variable cost per unit of $30. Calculate the break-even point for the retail store.

3 A manufacturing company has fixed costs of $200,000, a sales price per unit of $100, and a variable cost per unit of $70. Calculate the break-even point for the manufacturing company.

4 A restaurant has fixed costs of $80,000, a sales price per unit of $20, and a variable cost per unit of $12. Calculate the break-even point for the restaurant.

5 A service-based business has fixed costs of $30,000, a sales price per unit of $100, and a variable cost per unit of $20. Calculate the break-even point for the service-based business.

6 A software company has fixed costs of $150,000, a sales price per unit of $200, and a variable cost per unit of $50. Calculate the break-even point for the software company.

7 A consulting firm has fixed costs of $50,000, a sales price per unit of $500, and a variable cost per unit of $200. Calculate the break-even point for the consulting firm.

Return on Investment

We covered the concept of ROI earlier in this course. Understanding ROI allows you to assess how much you have made from a business investment. Calculating return on investment can help you decide whether to continue investing in a particular activity.

Use the following formula to calculate return on investment.

((Amount generated - Cost of investment)/Cost of investment) x 100

1 An individual invests $10,000 in a stock and sells it later for $12,500. Calculate the return on investment for the individual.

2 A business invests $50,000 in marketing campaigns and generates an additional $100,000 in revenue. Calculate the return on investment for the business.

3 An individual invests $5,000 in a real estate property and sells it later for $6,500. Calculate the return on investment for the individual.

4 A company invests $100,000 in a new production facility and generates $150,000 in additional profits. Calculate the return on investment for the company.

5 An individual invests $20,000 in a startup and receives $30,000 in return. Calculate the return on investment for the individual.

Differentiating Fixed and Variable Costs

1 A manufacturing company has the following costs in a month:

- Rent: $2,000
- Raw Materials: $3,500
- Salaries: $5,000
- Property Tax: $600

Determine the fixed costs and variable costs for the company.

Calculating Monthly Payroll Expenses

1 Calculating Monthly Payroll Expenses A company has the following employee salaries for a month:

- Employee A: $3,500
- Employee B: $4,200
- Employee C: $2,800
- Employee D: $3,900

The company also pays its accountant a monthly salary of $5,500. Calculate the total monthly payroll expenses for the company.

Calculate total assets, total liabilities, and shareholders' equity

1 The following information is given for a company:

- Current Assets: $50,000
- Non-Current Assets: $100,000
- Current Liabilities: $30,000
- Long-Term Liabilities: $50,000

Calculate the total assets, total liabilities, and shareholders' equity for the company.

15.3 Entrepreneurship and Starting a New Business

Entrepreneurship refers to the process of starting, managing, and operating a business venture with the aim of creating and delivering value through innovative ideas, products, or services. Entrepreneurs play a vital role in driving economic growth and creating job opportunities.

From a financial perspective, entrepreneurs need to consider various costs and steps in order to launch and sustain their business. Here are some key financial aspects that entrepreneurs should consider:

- **Start-up Costs:** These include the initial expenses required to establish the business, such as market research, product development, legal fees, permits, licenses, office space, equipment, and inventory. Entrepreneurs need to estimate and secure the necessary funding to cover these costs.
- **Operational Costs:** These are ongoing expenses required to run the business on a day-to-day basis. Operational costs may include rent, utilities, salaries and wages, raw materials, marketing and advertising, insurance, and maintenance expenses.

It is crucial for entrepreneurs to carefully manage and budget for these costs to ensure the financial stability of the business.

- **Financing:** Entrepreneurs often need to secure financing to fund their business. They can consider various financing options, such as self-funding (using personal savings), loans from banks or financial institutions, angel investors, venture capital, crowdfunding, or government grants. Entrepreneurs need to assess the different sources of financing and determine the most suitable option based on their business needs and goals.
- **Revenue Generation:** Entrepreneurs must develop a clear revenue model to generate income and sustain their business. They need to identify their target market, determine pricing strategies, and create effective sales and marketing plans to attract customers and generate sales.
- **Cash Flow Management:** Managing cash flow is crucial for the financial health of a business. Entrepreneurs need to ensure that they have enough cash to cover expenses, meet financial obligations, and invest in growth opportunities. This involves monitoring and projecting cash inflows and outflows, optimizing payment terms with suppliers and customers, and implementing effective cash flow management strategies.
- **Financial Planning and Forecasting:** Entrepreneurs should create a comprehensive financial plan and forecast to guide their business decisions. This involves developing a budget, projecting revenue and expenses, conducting financial analysis, and setting financial goals. Financial planning helps entrepreneurs track their progress, make informed decisions, and adapt their strategies as needed.
- **Risk Management:** Entrepreneurs need to assess and manage various financial risks associated with their business. This may include risks such as market fluctuations, competition, regulatory changes, credit risk, and operational risks. Implementing risk management strategies, such as diversifying revenue

streams, obtaining insurance coverage, and maintaining emergency funds, can help entrepreneurs mitigate financial risks.

- **Financial Reporting and Compliance:** Entrepreneurs must maintain accurate financial records and comply with applicable financial regulations and reporting requirements. This includes keeping track of income and expenses, filing taxes, preparing financial statements, and adhering to accounting standards. Entrepreneurs may need to seek professional assistance from accountants or financial advisors to ensure compliance and accurate financial reporting.

These are some of the key financial considerations and steps that entrepreneurs should keep in mind when starting and operating a business. Being financially savvy and proactive can contribute to the long-term success and sustainability of their entrepreneurial ventures.

Let's try some questions related to business expenses.

1 John earns a monthly salary of $3,500 from his full-time job. He decides to start his own business, which costs him $1,200 per month to run. Calculate John's total monthly income and expenses.

2 Samantha earns a monthly salary of $4,000 from her full-time job. She decides to start her own business, which requires her to pay $500 for equipment and $300 for monthly rent. Calculate Samantha's total monthly income and expenses.

3 Anna earns a monthly salary of $3,000 from her full-time job. She estimates that by starting her own business, she can generate monthly revenue of $5,000 although her business expenses would amount to $4,500. Should Anna quit her full-time job to start this business?

4 John is considering starting a new business. He currently earns a monthly salary of $2,500 from his full-time job. He estimates that his monthly personal expenses amount to $1,800. If he starts the business, he expects his monthly

business expenses to be $1,200. Calculate John's monthly income and savings after deducting personal and business expenses.

5 Sarah is considering starting a new business. She currently earns a monthly salary of $3,000 from her full-time job. Her monthly personal expenses amount to $2,000. If she starts the business, she expects her monthly business expenses to be $1,500. Calculate Sarah's monthly income and savings after deducting personal and business expenses.

6 Emily earns a monthly salary of $2,800 from her full-time job. Her monthly personal expenses amount to $1,500. If she starts the business, she expects her monthly business expenses to be $800. Calculate Emily's monthly income and savings after deducting personal and business expenses.

7 Alex earns a monthly salary of $3,500 from his full-time job. His monthly personal expenses amount to $2,000. If he starts the business, he expects his monthly business expenses to be $1,200. Calculate Alex's monthly income and savings after deducting personal and business expenses.

8 John wants to start a small bakery. He needs to take out a loan of $50,000 to cover the initial setup costs. The bank offers him a loan with an interest rate of 8% per year. If the loan term is 5 years, calculate the total amount John will have to repay, including interest.

9 Sarah wants to start a graphic design business. She needs to take out a loan of $25,000 to purchase necessary equipment. The bank offers her a loan with an interest rate of 6.5% per year. If the loan term is 3 years, calculate the total amount Sarah will have to repay, including interest.

Let's Explore

10 Imagine you have decided to become an entrepreneur and start a digital marketing agency. You've invested 20,000 Euros of savings into launching your business, which includes website development, marketing materials, and initial client acquisition efforts. After a year of hard work, your business starts generating a consistent income of 3,000 Euros per month, covering your personal and business expenses.

However, your life takes a significant turn: you get married and soon after, you and your spouse welcome a baby. With the arrival of your child, you now have additional expenses, including medical and baby-related expenses of 300 Euros per month.

A How might your decision to become an entrepreneur impact your personal financial stability, especially considering the initial investment and income fluctuations that often accompany startup ventures?

B With the arrival of a child, what adjustments and financial considerations should you make to ensure your family's financial well-being?

C How can you strike a balance between pursuing your entrepreneurial dream and providing financial security for your family during these challenging circumstances?

Conclusion

- Congratulations on completing the financial literacy course!
- During the course, we explored various areas, such as budgeting, saving, investing, understanding credit and debt, and making informed financial decisions. These topics are vital for your success in navigating the complex world of personal

finance. By gaining knowledge and skills in financial literacy, you have taken a significant step towards securing a better financial future.

- Remember, financial literacy is not a one-time achievement but an ongoing journey. As you move forward, continue to apply the principles and strategies you have learned. Regularly review your budget, track your expenses, and save consistently. Explore different investment options to grow your wealth over time, and make smart choices when it comes to borrowing and managing credit.
- Financial literacy is about being proactive and empowered. It's about understanding the importance of setting financial goals, planning for the future, and being prepared for unexpected expenses. By implementing the knowledge gained from this course, you can build a solid financial foundation that will serve you well throughout your life.
- Always stay curious and continue learning about personal finance. Stay updated on current financial trends, seek advice from trusted sources, and never hesitate to ask questions. Remember, the more you know, the better equipped you will be to make sound financial decisions§.
- As you embark on your journey toward financial independence and security, remember that financial literacy is a lifelong skill. By being mindful of your financial choices, practicing discipline, and staying informed, you have the power to create a bright financial future for yourself.
- Wishing you all the best in your financial endeavors!
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