EN

Hands-on SHAFE

BUSINESS 06

Financial forecasts

A preparation stage of a business plan

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Hands-on SHAFE

BUSINESS MODULE 6

Financial forecasts

This module aims to help you create your own financial forecasts.

What will you learn in this module

1. What are financial forecasts.
2. Why we do financial forecasts.
3. How to do financial forecasts.

Chapters in this module

Hands-on SHAFE

BUSINESS | MODULE 6 | CHAPTER 1

What are financial forecasts?

In this chapter, you will learn what financial forecasts look like and how they are linked to the topics that were covered in the other BUSINESS modules.

What will you learn in this chapter

1. How your financial forecast is linked to your business plan.
2. Financial forecasts are not predictions.
3. How to make your own financial forecasts.

Financial forecasts and business plan

Financial forecasts form an important part of a business plan, and include:

- the financial projections of the project i.e., the financial forecasts.
- the written project with detailed information about **YOU**, your **BUSINESS PROJECT**, and the **BUSINESS ENVIRONMENT** (the 3 pillars). It explains also the data of the financial forecasts.

The written part will be studied in the module **BUSINESS 07 Business plan.**

Financial forecasts are not predictions

Financial forecasts are the translation, in data, of the different aspects of your project.

As you noticed through the previous stages, your project is multifaceted: warehouse, equipment, raw material, shipping, wages, taxes…

A company has hundreds of daily opportunities to earn and spend money. **In fact, each decision, and each daily action has a financial consequence**.

If these daily revenues and expenses are not correctly managed with the proper tools, the situation can quickly become unmanageable. A company that loses control of its budget is a company in danger.

The financial forecasting process uses different tools to consider several economic and financial scenarios.

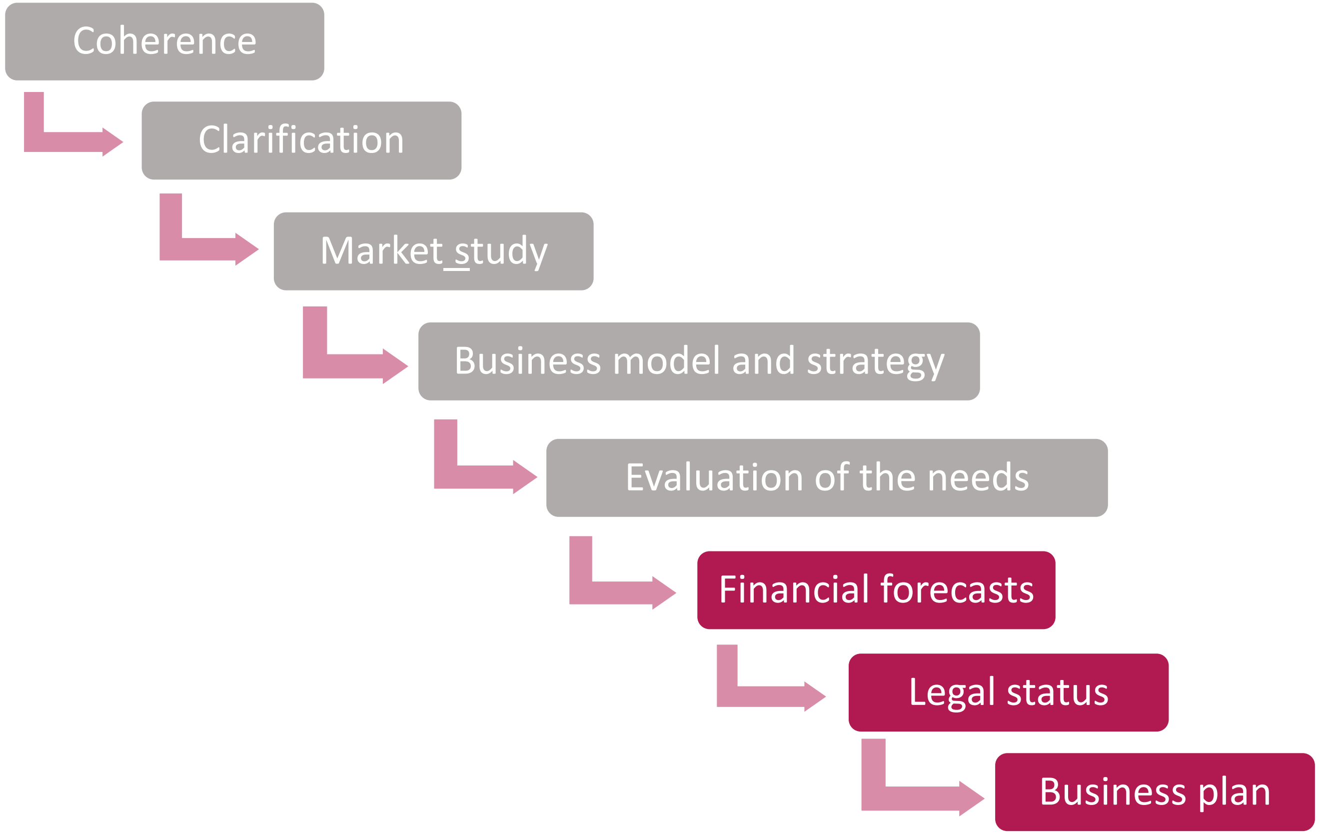
For instance, if you envisage different degrees of development of the activity, it may be useful to carry out several scenarios in order to verify the economic and financial consequences of the different strategies you have in mind.

Financial forecasts in the process

The financial forecasts are done at the end of the process in parallel with the choice of the legal status and the drafting of the detailed project presentation.

Of course, while doing the financial forecast, we go back and forth between the business plan (and obviously the financial forecasts) and the other steps to adjust the strategy and keep the coherence between all of them.

These steps are more or less based on standard formats which help managers to calculate, analyse, compare and validate what they consider the best scenario.



What do financial forecasts look like

There are tools for the calculations and tools for the presentation:

Several tables are used to perform calculations, as well as to justify results and conclusions. Of course, the complexity and variety of these documents depend on the size of the project, the challenges and the issues.

Various kinds of charts, like i.e. pie charts, column charts and graphs, are used to highlight important data, assist in the understanding of economic choices and decisions and help memorisation. All such charts are of course based on data.

The tables that usually appear in financial forecasts

The **financial plan** compares the **investments** that need to be made regarding your business plan and the potential **sources of financing**.

The **income statement** (profit and loss account) is the one where you subtract the **expenses** from the potential **turnover** to calculate the potential **profit.**

The **cash flow** diagram forecast is where you anticipate cash movements to identify the conditions to avoid a negative balance and avoid running out of cash - one of the most common causes of failure of start-ups.

The **balance sheet** forecast is a projection of **assets, liabilities,** and **equity** at a future point in time. It is used to approximate the future assets and liabilities(“debts”).

Turnover, profit, assets, liabilities and equity are terms that will be explained in the next slide.

Some vocabulary

Turnover	It is the total sales made by a business in a certain period.
Profit	It is the financial gain a business receives when revenue surpasses costs and expenses
Assets	It is an item of value owned by a company.
Liabilities	They are the legal debts a company owes to third-party creditors.
Equity	It represents the shareholders' stake in the company.

These terms will be described more accurately in the next chapters.

When do we need to make financial forecasts?

For a new business

In the business plan, at the very end of the process, more or less at the same time as the written part.

When you're going through the process of business creation, you collect information and organise it to validate every hypothesis, every decision and choice.

For the takeover of a business

When you plan to buy a company, you need to evaluate the commercial and financial risk you will take. You are given documents and information from the past and present and you consider for the future a strategy based on this information and the data that you gathered by yourself.

You define a development that meets your objectives and check, via the forecast, whether it is feasible.

To develop your business

When you consider (or want) to develop your business to reach different goals. For example, if you want to increase the turnover, add new activities, transform the structure, move to a better or larger place, attract financial partners or adapt to an environmental change. In all these cases you need to make financial forecasts. Then you will be able to measure the consequences on the company.

But also, every time there are or will be major changes in at least one of the three pillars of your business.

Why three-year financial forecasts?

Typical business plans, tend to use **three-year benchmarks**.

There are 2 main reasons for that :

- The highest number of bankruptcies occurs in the first 3 years.
- It is enough time to provide an analysis of the start-up and development of a business.

Sometimes, for small businesses with a regular activity a one-year financial forecast can be enough, as the following years should be the same as the first one.

However, 5-year financial forecasts might be requested by the bank or a financial partner to have a better idea of the longer-term ability to repay a loan for example.

Chapter summary

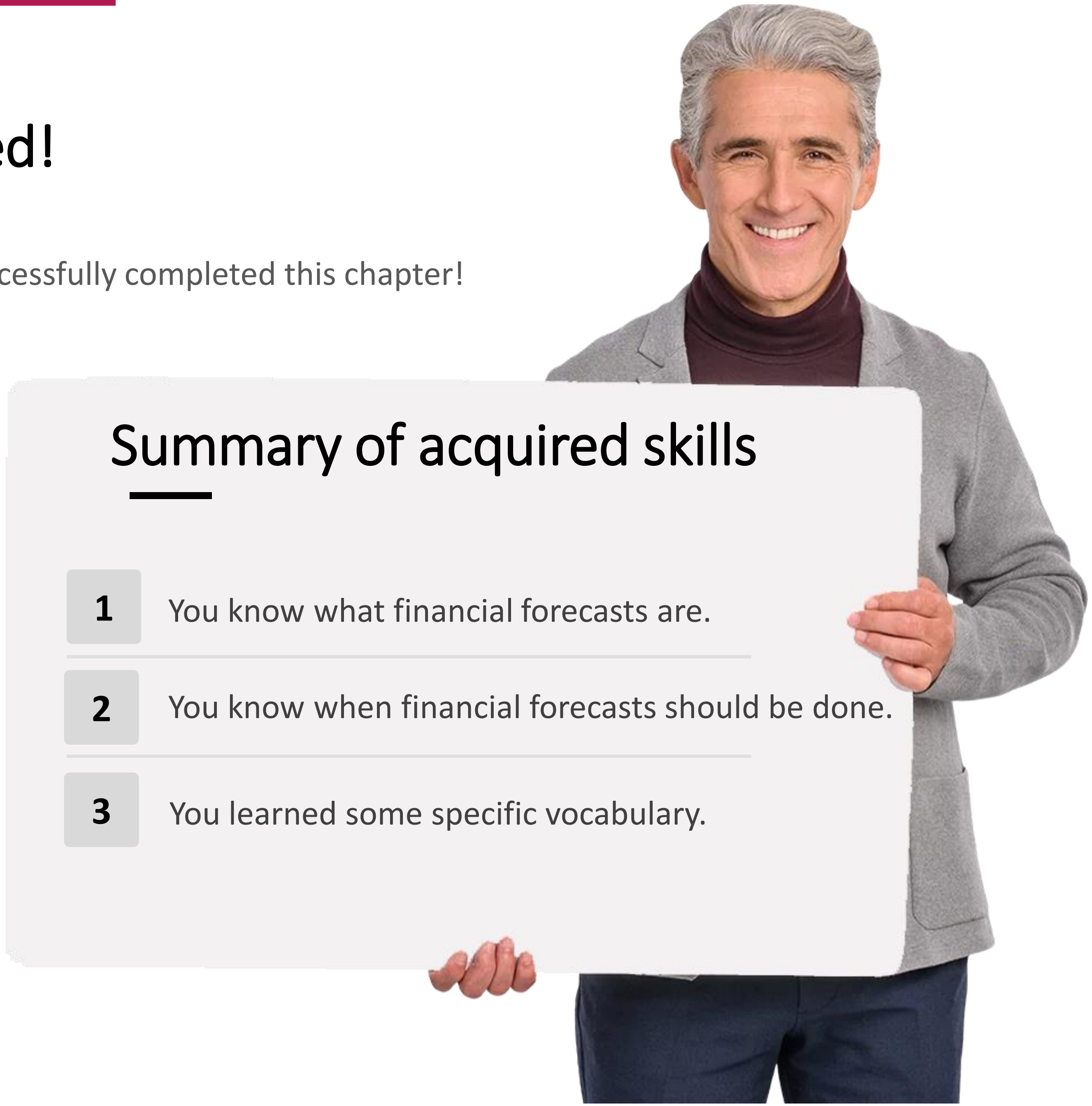
1 The financial forecasts are part of the business plan.

2 The financial forecasts are tables and charts.

3 The financial forecasts can be used either before the creation of the business or for its development.

Chapter completed!

Congratulations! You have successfully completed this chapter!



What is next?

Now you can either repeat this chapter or follow our study recommendation by clicking on one of the buttons below:

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Why do financial forecasts?

In this chapter you will learn why financial forecasts are so important for you and your partners and why you should take care of these.

What will you learn in this chapter

1. Why doing financial forecasts is important for you.
2. Why doing financial forecasts is important for your partners.
3. Why doing financial forecasts is important for your business.

For you

Doing your financial forecasts will help you:

- **To measure the profitability** and identify the **conditions to have a sufficient income** regarding your personal requirements.
- To **identify the financial risk or opportunity** the project represents.
- To **estimate the working time** involved.
- **To put a figure on your objectives** and make them concrete.
- **To project yourself into your business** with realistic figures based on accurate information. This initial work allows them to get to the heart of the matter.
- To know **how much of your own funds** you should invest.
- **To convince your partners** that you and your project are serious.

Did you know?

You can have the financial forecasts done by professionals or **do them yourself with the help** of financial advisors.

It is an opportunity to acquire new skills.

For your partners

Doing financial forecasts will help you:

- **To present** to your bank **the amount of money you need to borrow**, why and how you could repay it. This will help the bank decide if they can/want to make a loan.
- **To present** to local or regional authorities, **the number of jobs that you want to create**, for example, and thus negotiate total or partial exemptions from local taxes or to benefit from other types of support.
- **To negotiate with the main suppliers**, for example, the payment terms and conditions and the delivery conditions.
- **To help** partners **understand the scenario** you have built and your understanding of the figures.
- To **attract investors.**

For your future business

- Financial forecasting is a **tool** that will give your business a better chance to develop and survive the 3 first years.
- It is a **roadmap** that allows you to follow the evolution of key parameters, figures and data such as turnover, expenses, profit…
- It is very important to update the forecasts regularly to **evaluate the differences between your initial forecasts and reality.**
- You can then obtain a new scenario with the updated data and though adapt your strategy.
- By regularly updating your financial forecasts, you give yourself the means to anticipate possible financial problems and act accordingly.

Chapter summary

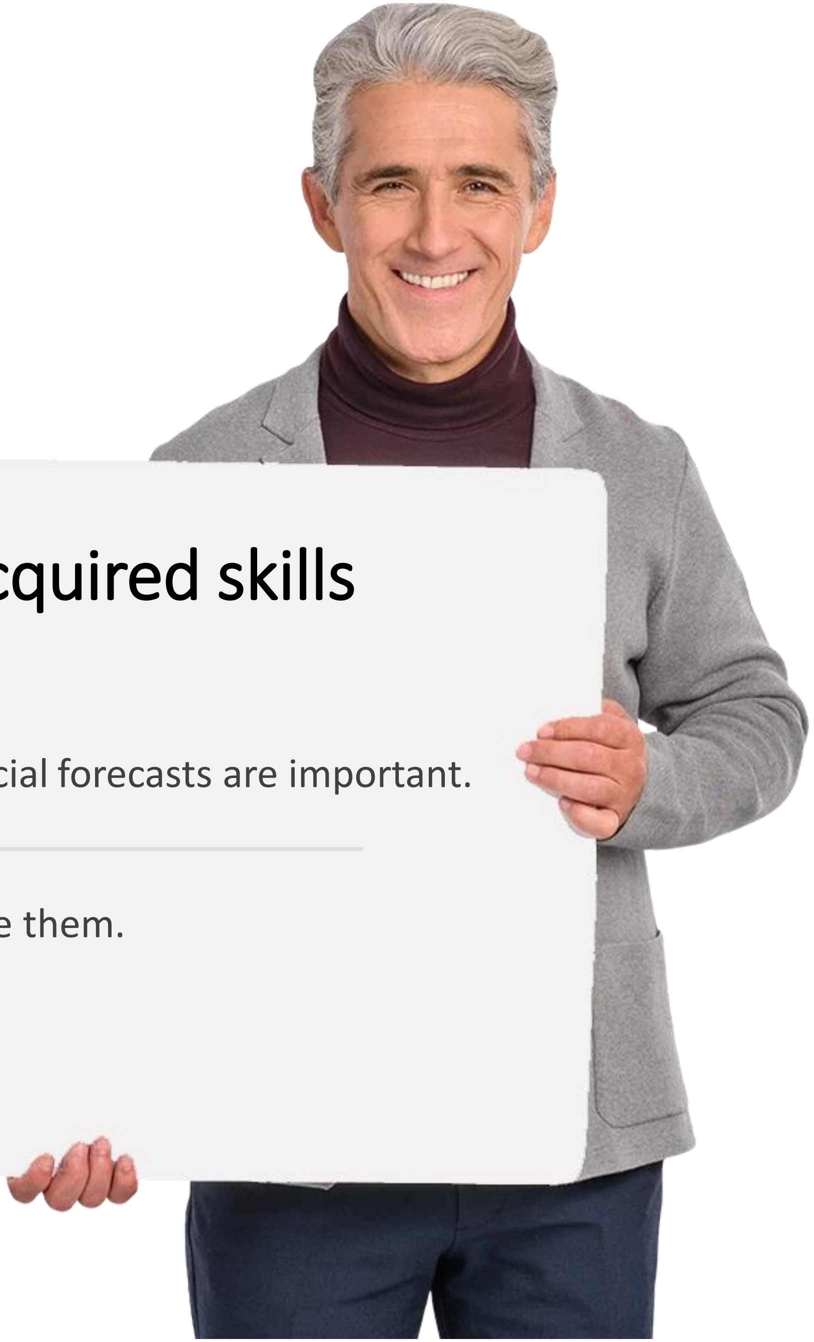
1 The financial forecasts are tools that help you to validate the best business scenario.

2 The financial forecasts are used to discuss with your potential partners.

3 The financial forecasts are used as business roadmaps.

Chapter completed!

Congratulations! You have successfully completed this chapter!



Summary of acquired skills

1. You know why financial forecasts are important.
2. You know how to use them.

What is next?

Now you can either repeat this chapter or follow our study recommendation by clicking on one of the buttons below:

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BUSINESS | MODULE 6 | CHAPTER 3

Financial plan

Every project starts with clearly defined needs. In this chapter, we'll look at how the financial plan can help you formalize your needs at the start of the business.

What will you learn in this chapter

1 What is a financial plan and what is its purpose?

2 What do you need to start working on your financial plan?

3 How to complete your financial plan.

What is a financial plan?

The financial plan is a table that allows you to measure the **financial feasibility** of the creation of a company. It answers this question: what money is needed to launch the project and how to raise it?

In other words, the financial plan allows you to **verify that you will have the funds necessary to finance the major expenses required to launch your business.**

What do you need to start your financial plan?

To create a financial plan, you will need to visualise your business and know its financial and economic characteristics. In other words, **you need to know what you want to do and how you want to do it.**

In fact, how can you evaluate your material and immaterial needs, without having really defined all aspects of your activity?

The better you visualise the beginning of your activity, the better you will be able to evaluate what you need to start.

A financial plan is broken down into two main columns: the start-up **needs, and the resources** intended to finance these needs.

Resources must always be equal to needs.

If your needs are greater than your resources, you must either reduce your needs or increase your resources.

If your resources are greater than your needs, this is not a problem, on the contrary, you can consider this excess of resources as a bonus.

Let's take a closer look at these needs and resources.

Different types of start-up needs

Your needs can be very diverse. They can be material or immaterial. Let's take a closer look at some common start-up needs.

Immaterial needs

There are a lot of intangible needs that we don't necessarily think about:

- Software licenses
- Patents
- Leasehold rights
- Research and development investments
- Websites
- Start-up costs: registration, consulting…

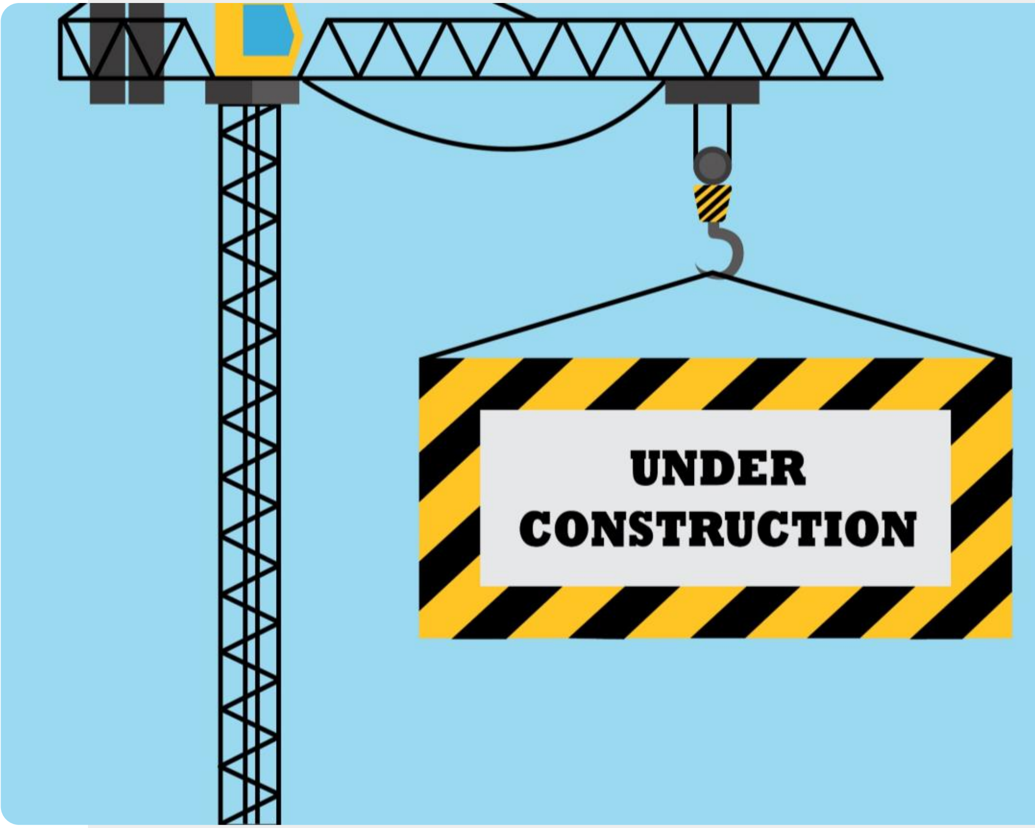
Building needs and layout

Perhaps you will need to build or renovate buildings like offices or a warehouse or a car park for instance?

Perhaps, you may need to set up a baking lab or a carpenter's workshop?

Perhaps you will have to bring the electricity or plumbing up to standard?

These needs are very costly, in general, and must be scrupulously detailed to avoid bad surprises.



Material needs

What objects and other machines do you need to buy to start your business?

For instance:

- A car or a truck
- Office furniture
- Professional appliances: Fridge, oven, dishwasher
- Digital devices: laptop, printer, screens
- Machines and tools, ICT infrastructure

Financial needs

There are mainly three financial investments: guarantee/security deposit, shares/stocks and debt rights.

In most cases, if you are a tenant, you will be concerned about the security deposit.

Working capital requirement

The working capital requirement is the amount of money a company needs to pay its current expenses while waiting to receive payment from its customers.

In other words, before receiving the money from its first sales, a company must buy and pay what is necessary to make its first sales. This includes the purchase of raw materials, manufactured goods, gasoline costs, rent, insurance...

It is generally recommended to have a working capital requirement equal to several months of current expenses. We will see later what we mean by current expenses.

Different types of resources

Once you have listed all your needs, you must verify that your resources allow you to finance them.

There are different types of resources, let's take a closer look.

Personal contribution

Your personal contribution can be made in cash (sum of money paid into the company's account) or in kind (mainly material contributions like a car, a laptop or other small equipment).

For the financial health of your company, as a general rule, the larger your personal contribution the better because you reduce your dependence on external financing (banks etc.). Your personal contribution directly ensures your financial autonomy.

Bank loan

Apart from your personal contribution, the second source of financing for your company is often a bank loan.

The larger your bank loan, the greater your dependence on third parties (the bank in this case). In other words, the less independent you are.

Aids and grants

The third source of funding is generally aid.

Examples include:

- Publics grants
- Interest-free loans
- Foundation/Association grants
- Crowdfunding
- Material donation
- Other forms of foreign private investment (private entities or companies)

An example of financial plan

It's time to take a closer look at what a financial plan looks like.

Let's take the example of the home meal delivery company that we have seen in the previous modules.

The start-up needs

Type of investment	Detail of the investment	€	Provider
Immaterial (TOTAL = 8.000€)	Start-up cost: registration + financial consulting	1.500€ + 500€ = 2.000€	Chamber of commerce + Certified accountant
	Website creation	3.500€	Web developer
	Software license	1.000€	… company
	Leasehold rights	1.500€	The lessor or outgoing tenant
Building, renovation and layout (TOTAL = 4.500€)	Renovation of the office: electricity + plasterboard + light system upgrading	2.000€ + 1.500€ + 1.000€ = 4.500€	Plumber, electrician...
Material (TOTAL = 17.800€)	Transport: refrigerated van	7.000€	…
	Conservation: cold room	5.000€	…
	Preparation: kitchen lab (*see annex 1 for more details*)	4.000€	…
	IT equipment (*see annex 2 for more details)*	1.800€	…

The start-up needs

Type of investment	Detail of the investment	€	Provider
Financial (TOTAL = 1.200€)	Security deposit (rent)	1.200€	…
Working capital requirement (TOTAL = 5.500€)	First stock of raw material	1.500€	…
	Cash flow (bank account balance)	4.000€	…
TOTAL INVESTMENT = 37.000€			

The resources

Type of investment	Detail of the investment	€	Provider
Personal contribution	Cash inflow	15.000€	My savings
Bank loan	6 years loan at 1,5% interest	15.000€	Bank …
Aids & grants	Installation grant from municipality	7.000€	
TOTAL RESOURCES = 37.000€			

Annex 1 : Details about kitchen lab

Detail of the investment	€	Provider
Kitchen sink	700€	
Workbench	1.000€	
Cooker hood	800€	
Dishwasher	600€	
Oven	600€	
Induction plate	300€	
TOTAL = 4.000€		

Did you know?

A financial plan must be balanced, i.e., the resources should be (at least) equal to the needs.

Use the formatting that suits you best

There is **no international standard for** completing **a financial plan**. Often, the simplest and most concise way is the best option.

As you saw in the example, **we highly recommend** you work **with 4 columns**; the type of investment (material or immaterial investment e.g.), the object of the investment (a truck, a fridge, a machine), the cost of the investment and the provider (where to buy it).

If an investment is broken down into a long list of small investments (the kitchen lab in the previous example), we recommend you make annexes with all the details. This way will help you to keep a readable financial plan.

In any case, the most important thing is to be organised. It means **you have to know the total amount of investments to be made and the details of each investment.**

If things are clear to you, if you can easily **keep track of each investment**, congratulations, you are on the right track to achieving a proper financial plan.

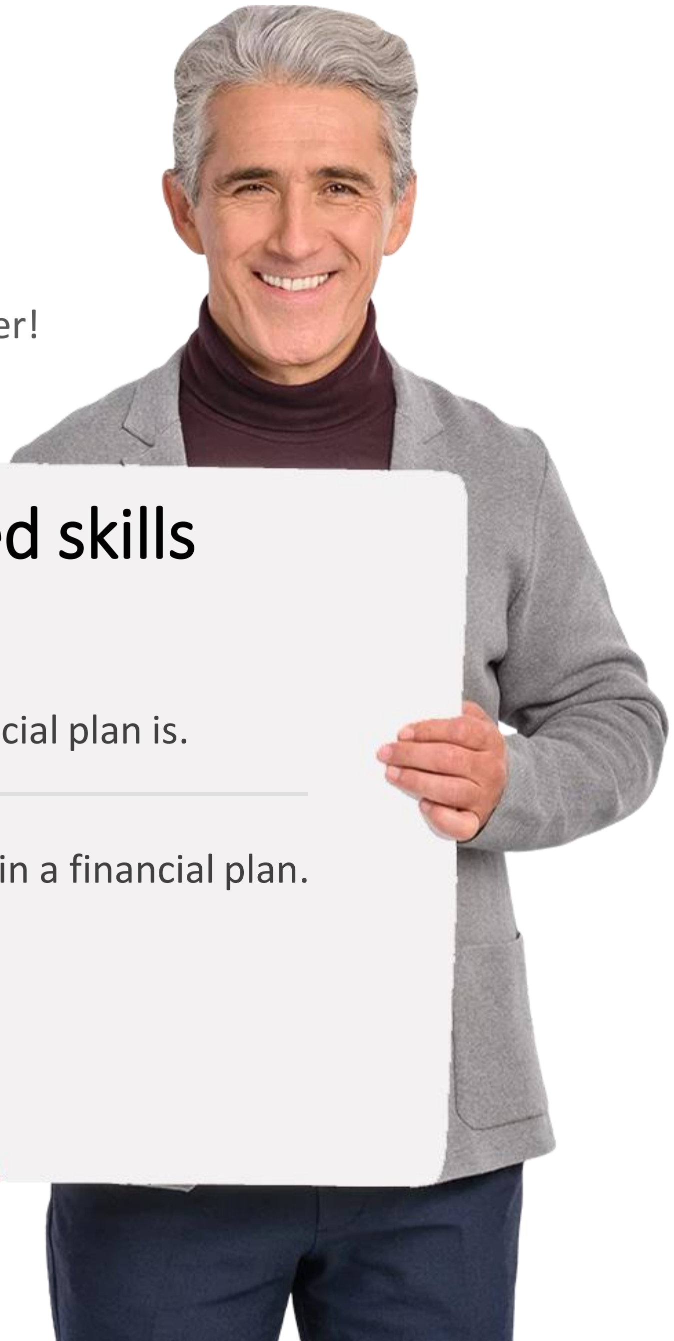
Chapter summary

1. A financial plan has 2 parts: the needs and the resources.

2. There is no standard presentation format for financial plans.

Chapter completed!

Congratulations! You have successfully completed this chapter!



Summary of acquired skills

1	You know what a financial plan is.
2	You know what to put in a financial plan.

What is next?

Now you can either repeat this chapter or follow our study recommendation by clicking on one of the buttons below:

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Hands-on SHAFE

BUSINESS MODULE 6 CHAPTER 4

Cash flow diagram

The cash flow diagram is a tool to help the anticipation of the cash movements on the bank account in order not to have a cash shortfall.

What will you learn in this chapter

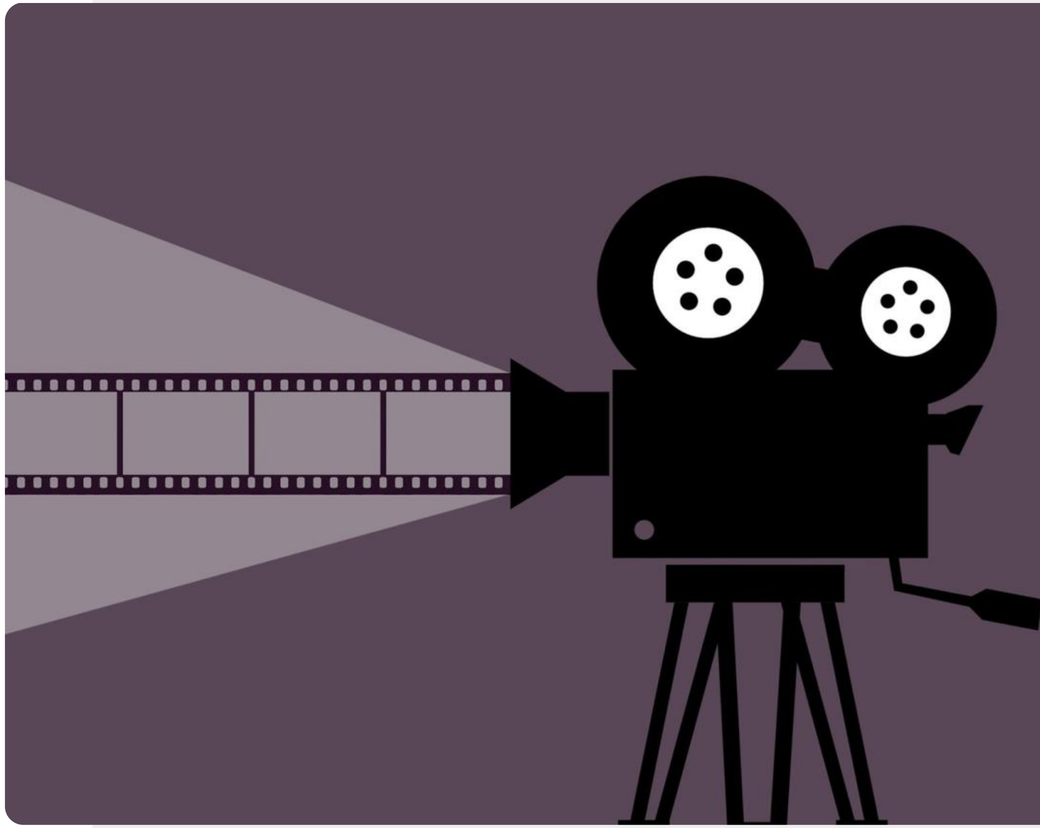
1 What are cash-flow fixed expenses?

Cash flow diagram

Remember: The financial plan has allowed you to list your initial needs and their sources of finance.

If the financial plan is a picture of the company's assets at the start of the activity, then the cash flow diagram is a film of the financial activity over several months.

Now, let's leave the start of the activity and the financial plan to address the case of an ongoing company.



The cash flow diagram is a movie of your business

A cash flow diagram is a tool (usually in the form of a table) in which you list all expected income and expenses broken down, week by week or month by month regarding your type of activity.

With this tool, you will be able to know instantly the cash balance of a desired period, and the cumulative balance from one period to another.

In other words, it is an important reference tool for managing your cash flow. But what is cash flow really? Let's find out.

What is cash flow?

The cash flow includes all the money that is directly available to the company.

In general, this is the amount available in the cash register or the company's bank account.

Cash flow is absolutely crucial to the proper economic and financial management of your company.

Cash flow has a direct link with the working capital requirement that we saw in the previous chapter.

As said in chapter 2, a company will often have to pay its expenses first before receiving the revenue from its sales.

The cash flow allows the company to pay all the expenses necessary to sell its products/services which will then generate revenues.

Without cash, you cannot pay your expenses and therefore cannot sell. This is why cash flow is the key element of good financial management and, consequently, of the company's sustainability.

Let’s take a look at a cash flow diagram on the next slides!

Example of cash flow diagram

	January 2022	February 2022	March 2022
INCOME	**TOTAL = +4.000€**	**TOTAL = +3.000€**	**TOTAL = +3.200€**
Meal delivery	*+4.000€*	+3.000€	+3.200€
EXPENSES	**TOTAL = -3.000€**	**TOTAL = -3.150€**	**TOTAL = 3.280€**
Gas	*-450€*	-320€	-400€
Car insurance	*-80€*	-80€	-80€
Car maintenance	*-120€*	-0€	-130€
Packaging of the meals	*-150€*	-100€	-120€
Online advertising	*-150€*	*-100€*	*-200€*
Web site maintenance	*-50€*	*-50€*	*-50€*
Wages	*-1.500€*	*-1.500€*	*-1.500€*
Taxes	*-500€*	*-1.000€*	*-800€*
CASH FLOW BALANCE OF THE MONTH	**+1.000€**	**-150€**	**-80€**
ACCUMULATED CASH FLOW BALANCE OVER MONTHS	**+1.000€**	**+850€**	**+770€**

Cash flow diagram precision

The example on the previous slide is a very simplified (and incomplete) version of what a cash flow diagram might look like. As with the financial plan, the goal of this type of tool is to identify, collect and organise all the income and expenses related to your business in a clear, precise and concise manner, month by month (or week by week depending on your type of activity).

The most important thing is to take into account all expenses and income and be as accurate as possible.

Now that you have a more accurate overview of what a cash flow diagram is, we will go into more detail!

Income

In the “INCOME" section you must detail all the projected income from the sales you expect. Use one table row per product or service type offered.

Be specific. Do not consider the **date of invoicing**, nor the date of the realization of the service or the sale of the product but the **date of the payment**.

For example, if your subscription-based business offer involves customers paying quarterly, expect to receive money quarterly, not monthly or weekly.

Expenses

In the “EXPENSES” section, the goal is to identify all expenses related to the activity. Use one table row per type.

Again, be specific. If an expense, such as an insurance fee, is paid once a year, list it as an annual expense, not a monthly one.

To help you identify your expenses, you can distinguish between fixed and variable expenses. Let's take a closer look.

Variable expenses

Variable expenses are directly influenced by your production/sales volume.

For instance, if you manage a restaurant, ingredient costs vary depending on whether you are cooking 30 or 60 meals per shift.

If you deliver prepared meals, your gas and car maintenance expenses are different if you deliver to 10 or 20 clients per day. Your packaging expenses also vary regarding the number of meals you package to deliver.

Variable expenses

Here is a non-exhaustive list of common variable expenses:

- Basic/Raw material
- Goods for resale
- Packaging
- Gas & energy expenses
- Supply costs
- Shipping costs
- Subcontracting costs
- Commission costs

Fixed expenses

Fixed expenses do not vary with your sales volume. Whether you sell 10 or 100 units of goods, the fixed expenses remain the same.

Here is a non-exhaustive list of fixed expenses:

- Insurance fees
- Bank account fees
- Rent
- Internet and phone subscription

Ambiguous expenses

There are some ambiguous expenses we also need to consider.

Electricity costs can be fixed or variable. For instance, if you are a web developer, your working tool is a computer. Whether you spend 8 hours or 12 hours a day working on your computer, your electricity bill will be about the same. In this case, it’s a fixed expense (even if it varies from a few euros).

If you are a ceramist, your working tool is a gas oven. If you run your oven for 1 hour or 6 hours a day, your gas bill will be very different. In this case, it is a variable load.

For this type of ambiguous expense, if a significant increase in your sales results in a proportionally small increase in your expenses, it is a fixed expense. Otherwise, it is a variable expense.

See annex 01 for more details

In the annex “HoS_TU_BUSINESS_06_Financial_Forecasts_Annex_01” you will find an example of a cash flow diagram that you can use as a tool.

If you use this tool, please fill in the red cells. Then, the rest of the spreadsheet will be automatically calculated.

Click on the annex buttons on the right to view the document in PDF format or download it in XLS format!

Cash flow budget

	2022												TOTAL
	1-Jan	1-Feb	1-Mar	1-Apr	1-May	1-Jun	1-Jul	1-Aug	1-Sep	1-Oct	1-Nov	1-Dec	
OPERATING INCOME & EXPENSES PART													
Sales n°1													0
Sales n°2													0
Sales n°3													0
	0	0	0	0	0	0	0	0	0	0	0	0	0
Basic/Raw material													0
Packaging													0
Goods for resale													0
Energy expenses													0
Supply costs													0
Shipping costs													0
Subconstrating costs													0
Travail expenses (airplane, hotel e.g.)													
Machine maintenance and repair													
Commission costs													0
TOTAL VARIABLE EXPENSES	0	0	0	0	0	0	0	0	0	0	0	0	0
Rent													0
Advertising													0
Bank													0
Insurance													0
Consulting (layer, accountant e.g.)													0
Subscription (internet, mobile phone...)													0
Website maintenance													0
Professionnal training													0
Documentation													0
Other costs													0
TOTAL FIXED EXPENSES	0	0	0	0	0	0	0	0	0	0	0	0	
Taxes													0
TOTAL TAXES	0	0	0	0	0	0	0	0	0	0	0	0	
Employees' salaries													0
Social contributions on employees' salaries													0
Business leader remuneration													0
Social contributions on business leader remuneration													0
TOTAL SALARIES AND SOCIAL CONSTRIBUTIONS	0	0	0	0	0	0	0	0	0	0	0	0	
TOTAL EXPENSES	0	0	0	0	0	0	0	0	0	0	0	0	0
DIFFERENCE BETWEEN INCOME AND EXPENSES	0	0	0	0	0	0	0	0	0	0	0	0	0
ACCUMULATED DIFFERENCE	0	0	0	0	0	0	0	0	0	0	0	0	
FINANCING PART													
Financial contribution													0
Aids/Grants/Subsidies													0
Taxes refunds													0
Bank loan													0
TOTAL OF RESOURCES	0	0	0	0	0	0	0	0	0	0	0	0	0
Immaterial needs													0
Building needs													0
Material needs													0
Financial needs													0
Stock of basic/raw materials													0
Stock of goods for resale													
Cash flow													0
TOTAL OF NEEDS	0	0	0	0	0	0	0	0	0	0	0	0	0
DIFFERENCE BETWEEN NEEDS AND RESOURCES	0	0	0	0	0	0	0	0	0	0	0	0	0
ACCUMULATED DIFFERENCE	0	0	0	0	0	0	0	0	0	0	0	0	
TOTAL DIFFERENCE BETWEEN INCOME+RESOURCES AND EXPENSES+NEEDS	0	0	0	0	0	0	0	0	0	0	0	0	0
ACCUMULATED DIFFERENCE	0	0	0	0	0	0	0	0	0	0	0	0	

View Financial Forecasts Annex 01 (PDF)

Download Financial Forecasts Annex 01 (XLS)

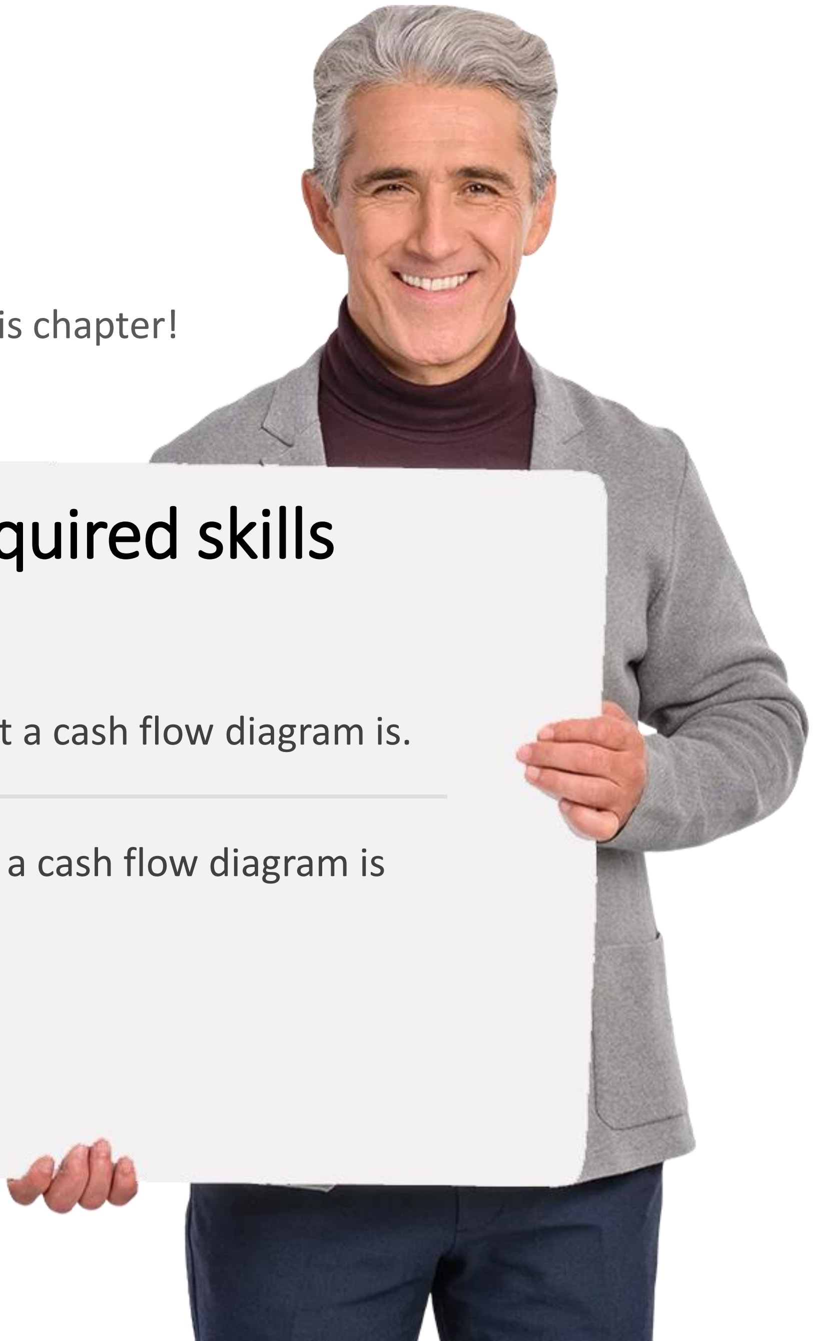
Chapter summary

1. A cash-flow diagram is a document that shows cash movements over a certain period.

2. It aims to anticipate needs and prevent a cash flow shortfall.

Chapter completed!

Congratulations! You have successfully completed this chapter!



Summary of acquired skills

1	You know what a cash flow diagram is.
2	You know why a cash flow diagram is important.

What is next?

Now you can either repeat this chapter or follow our study recommendation by clicking on one of the buttons below:

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Hands-on SHAFE

BUSINESS | MODULE 6 | CHAPTER 5

Profit and loss account

The profit and loss account helps with calculating different kinds of financial ratios.

What will you learn in this chapter

1 Profit and loss account is a table with the incomes on one side and the expenses on the other side.

2 You will know what profitability is.

3 You will discover some of the ratios that are based on the profit and loss account.

Profit and loss account

Cash flow budgeting has its limitations. Even if it gives indications about monthly revenues and expenses, it does not provide a precise and concise summary of your annual activity.

The cash flow diagram is the movie of your business activity, and the profit and loss account is the final picture.

Let's go into more details about this.

Profit and loss balance and profitability

The projected **profit and loss balance is a table that anticipates all the income and expenses** for each of the first three years of your business. It allows you to determine, in advance and approximately, the result (profit or loss) that you expect to achieve from your company's activity.

It is determined by two elements:

- **The projected turnover** which summarizes all the sales that will be made by the company.
- **The company's annual expenses** to achieve this expected turnover.

The **projected profit and loss balance is used to prove the profitability of the company to potential investors**. It also allows you to project yourself into the future and **validate your business mode**l.

Often, a business is not profitable in the first year. It is estimated that it takes 3 years for a business to start up. This is why it is generally recommended to make a 3-year forecast.

Let's take a closer look at what a profit and loss balance might look like.

An example of profit and loss account

Subject	€	%
Turnover	**62.000€**	**100%**
Variable expenses	15.000€	24% (of the turnover)
Fixed expenses	5.500€	9%
Taxes	1.000€	2%
Salaries and social contributions	15.000€	24%
Interest of the loan	500 €	1%
NET RESULT	**25.000€**	**40%**
CEO remuneration	15.000€	24%
Repayment of the loan	5.000€	8%
Savings	5.000€	8%

Don't confuse cash flow with profitability

The **cash flow diagram is a dynamic tool**. It allows you to **monitor**, on a daily basis, the state of your **cash flow**. **However, it does not help you to evaluate, over a year, the profit or loss that your company makes.**

In fact, it is important to distinguish between cash flow and profit and loss balance. Your cash flow might be healthy while your profit and loss balance can be disastrous. The opposite is also true.

Let’s take an example that illustrates that situation!

Let’s imagine you pay your suppliers within 60 days of receiving the products.

It means you receive and sell your products and then you pay your suppliers. Consequently, in that case, you receive the money from your sales before paying your expenses.

In this case, it is unlikely that you will have cash flow issues.

Nevertheless, if your margins are too low or your expenses are too high, you may end up making a loss at the end of the year (although the cash flow is positive because, in fact, you constantly benefit from a cash advance from your suppliers).

Don't confuse profitability with cash flow

Now let’s imagine that you realise a lot of sales, your margin is perfect and your expenses are low regarding your income. Your cash flow is positive and stable.

However, all of a sudden, you have to pay a large sum of money and more or less unforeseen annual expenses. In a single month, you have to pay your annual taxes as well as your employees' Christmas bonuses. You also have to pay for several thousand Euros worth of repairs on your main machine.

In this situation, you may not have enough cash to pay for all these expenses, although if you consider the sum of your annual income and expenses, the balance might be very positive.

Therefore, **cash flow should not be confused with the profitability of the company**. They are two different concepts. If one is failing, your business is in danger, even if the other is on the right track.

To summarise:

- Cash flow management = Cash flow diagram tool
- Profitability management = Profit and loss account.

These two tools are complementary and equally important in proper economic and financial management.

Ratios of the profit and loss account

Your profit and loss account is very useful to calculate ratios on different economic and financial aspects of your business. For example, ratios on profitability, margins, debt ratio, etc.

It is, as a rule, the basic tool for the financial/economic analysis of your activity. Any specialist, such as a banker or a potential investor, will refer to this tool to get an idea of the economic health of your business.

Let’s see some of these important ratios the economic and financial analysis of your activity.

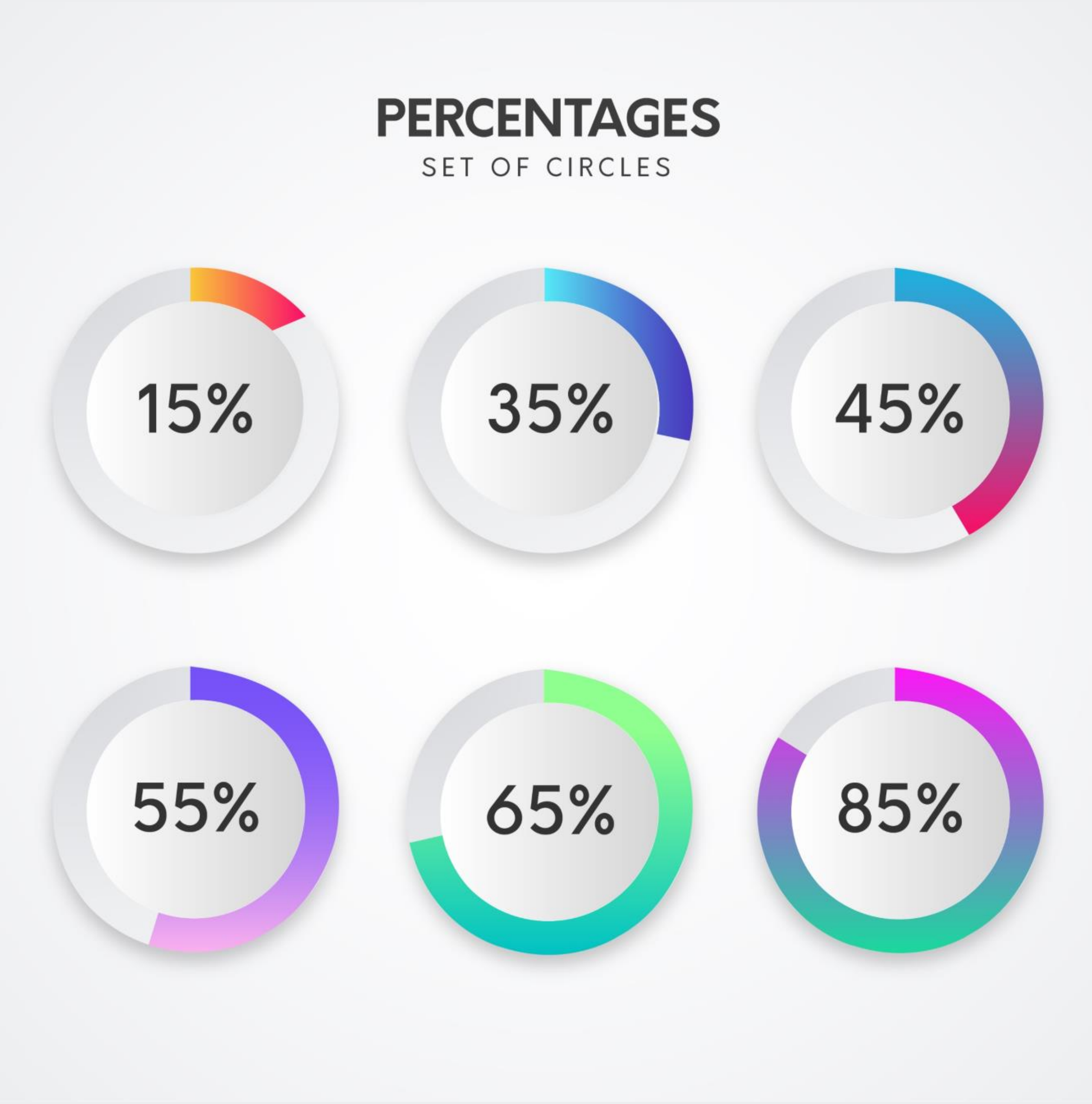
Margin on goods

This ratio allows you to determine the cost of your goods in relation to their selling price.

If this ratio is 65%, it means that on each product sold you make a margin of 35% or, in other words, that each product costs you 65% of its selling price.

The calculation of this ratio is: Variable expenses * 100 / Turnover.

There is no ideal margin. It depends mainly on your sector of activity.



Debt ratio

This ratio allows you to measure the portion of your bank loan to be repaid annually in relation to your net profitability.

What your annual loan repayment represents in relation to your profit?

The calculation of this ratio is: repayment of the loan * 100 / Net profit.

As a general rule, it is recommended not to exceed 25% of the annual loan repayment of your net profit. Of course, this recommendation may change depending on the financial and economic context of your activity.

Net savings

This ratio measures the savings generated by the company in relation to net profit.

The calculation of this ratio is : Savings*100 / Net profit.

As a general rule, it is recommended to save at least 15% of your net result, the more the better.

Chapter summary

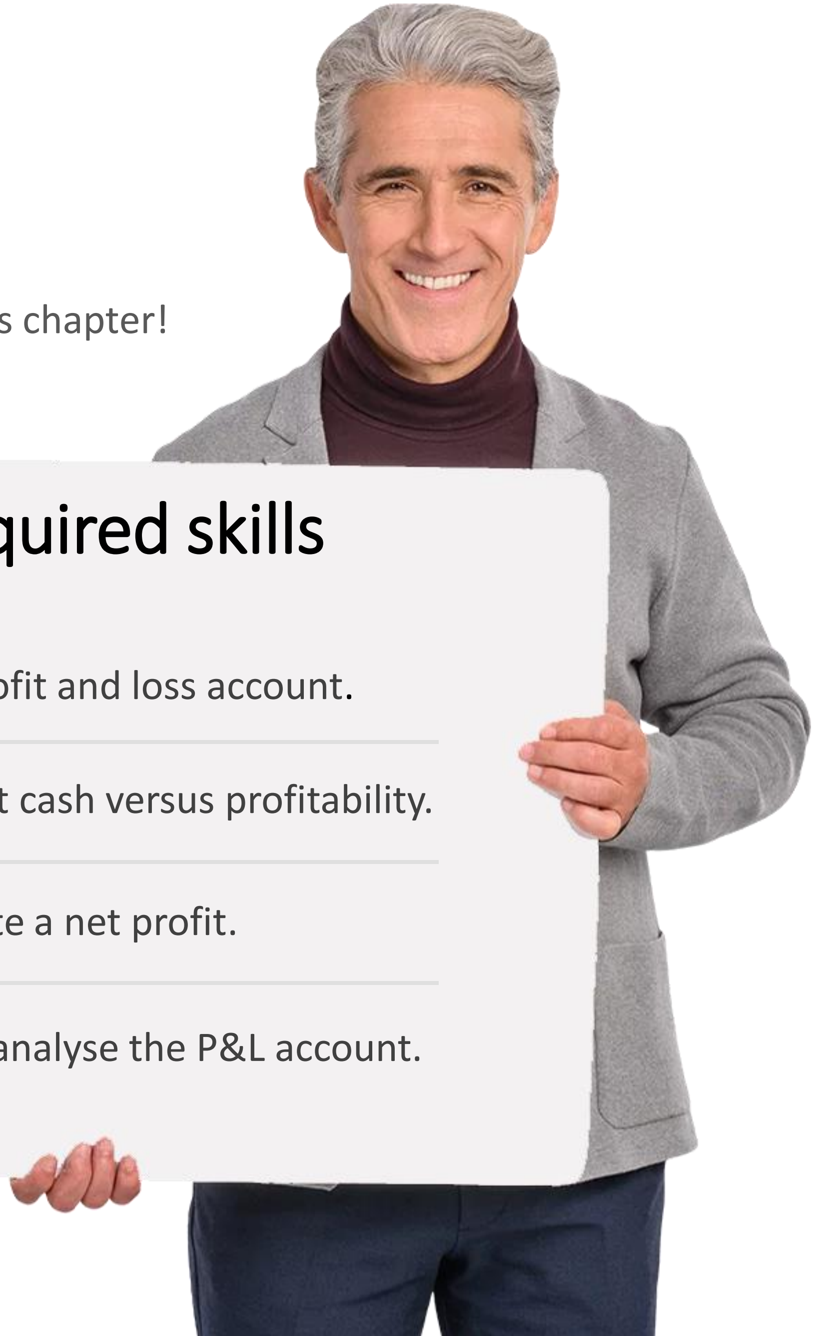
1. In a profit and loss account you find the expenses and incomes.

2. Calculate the profitability.

3. Many economic ratios are based on the profit and loss account.

Chapter completed!

Congratulations! You have successfully completed this chapter!



Summary of acquired skills

1. How to do a profit and loss account.
2. You know about cash versus profitability.
3. How to calculate a net profit.
4. Using ratios to analyse the P&L account.

What is next?

Now you can either repeat this chapter or follow our study recommendation by clicking on one of the buttons below:

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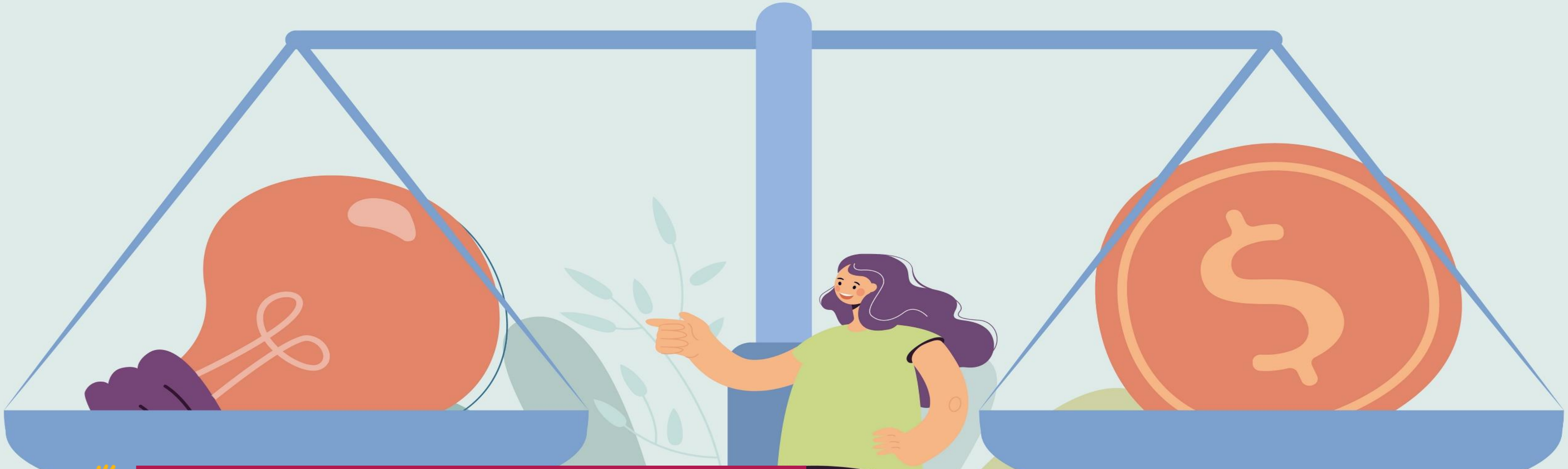


BUSINESS | MODULE 6 | CHAPTER 6

Balance sheet

The balance sheet is a financial statement where you can find what the company owns and what it owes to third parties.

What will you learn in this chapter

1. What is a balance sheet?
2. The difference between solvency and liquidity.
3. What is bankruptcy?

Balance sheet definition

The balance sheet is a document that describes what the company owns (**its assets**) and what it owes **(its liabilities**); in other words, the resources committed to financing its assets.

It is often used by third parties and partners (banks, customers, management committee, shareholders, ...) **to know the value of the company and ensure its solvency and liquidity**.

More simply, the balance sheet allows, among other things, to measure the value of a company.

The balance sheet can be broken down into 4 categories: stable and current assets and stable and current liabilities.

Solvency, liquidity, assets, liabilities, that's a lot of incomprehensible words, isn't it?

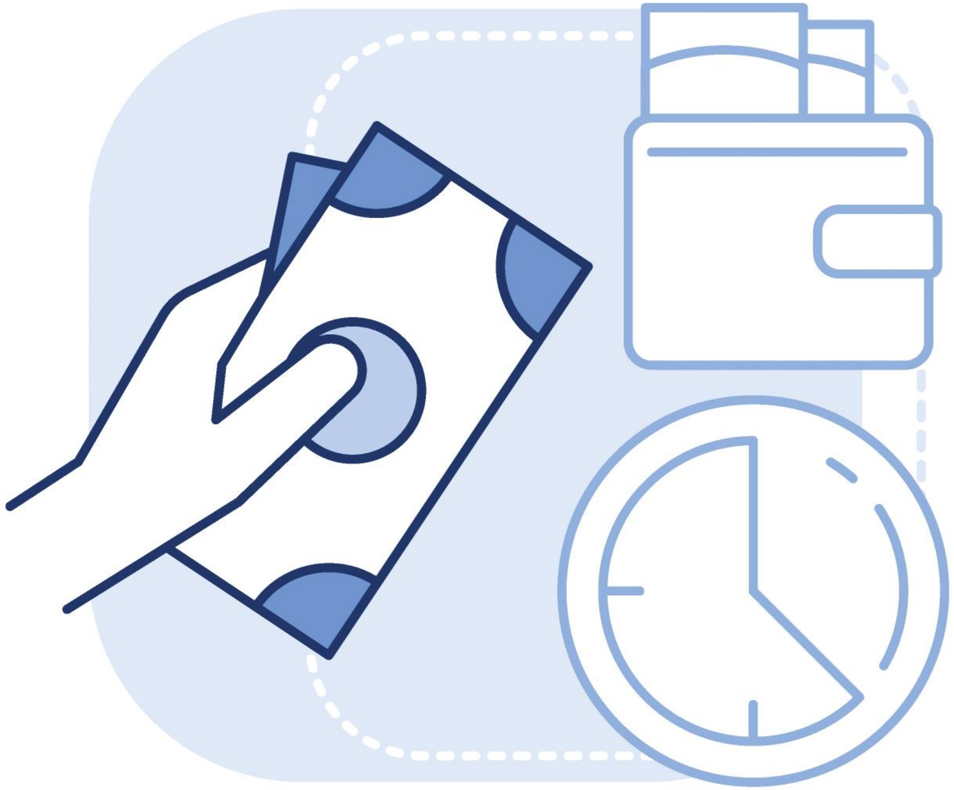
It's time to clarify all that!

Solvency

Solvency is the ability of a company to have **sufficient financial resources to pay its debts** in the short, medium and long term.

In other words, a solvent company is one whose resources (what it owns) are more important than its debts and commitments to third parties.

ASSETS ≥ LIABILITY (DEBTS)

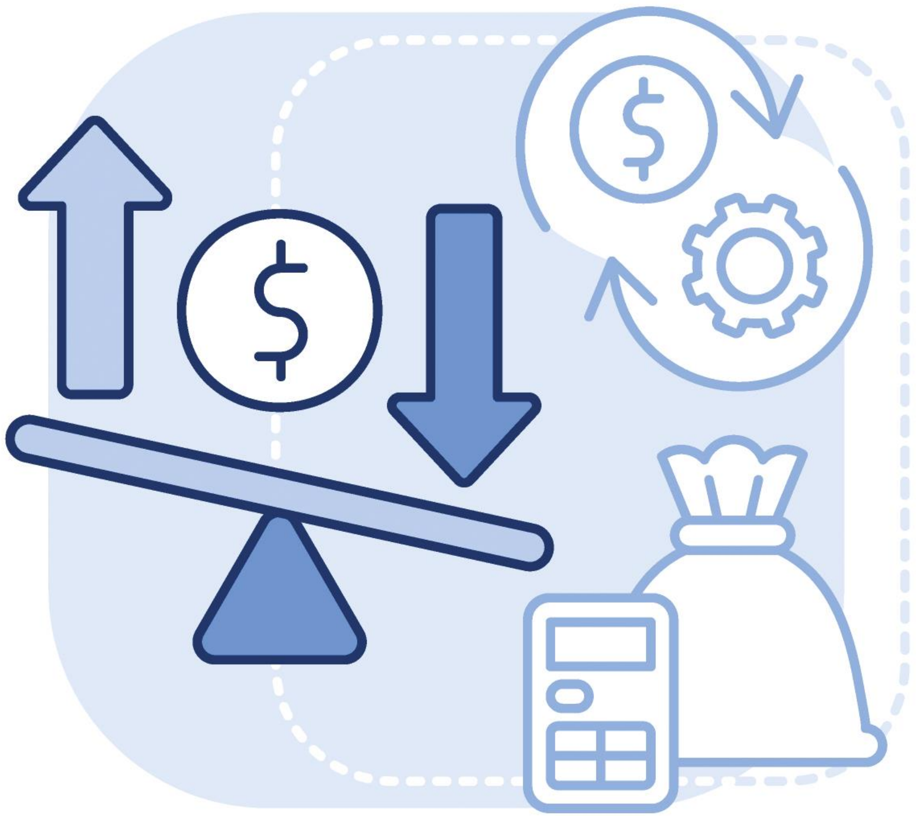


Liquidity

A company can be solvent but illiquid.

Liquid assets are all the **resources immediately available** to the company **to pay its short-term debts**.

For instance, a stock of raw materials can be easily sold to get cash without affecting its market price. This stock is therefore considered to be a liquid asset, just like money in a bank account for example.

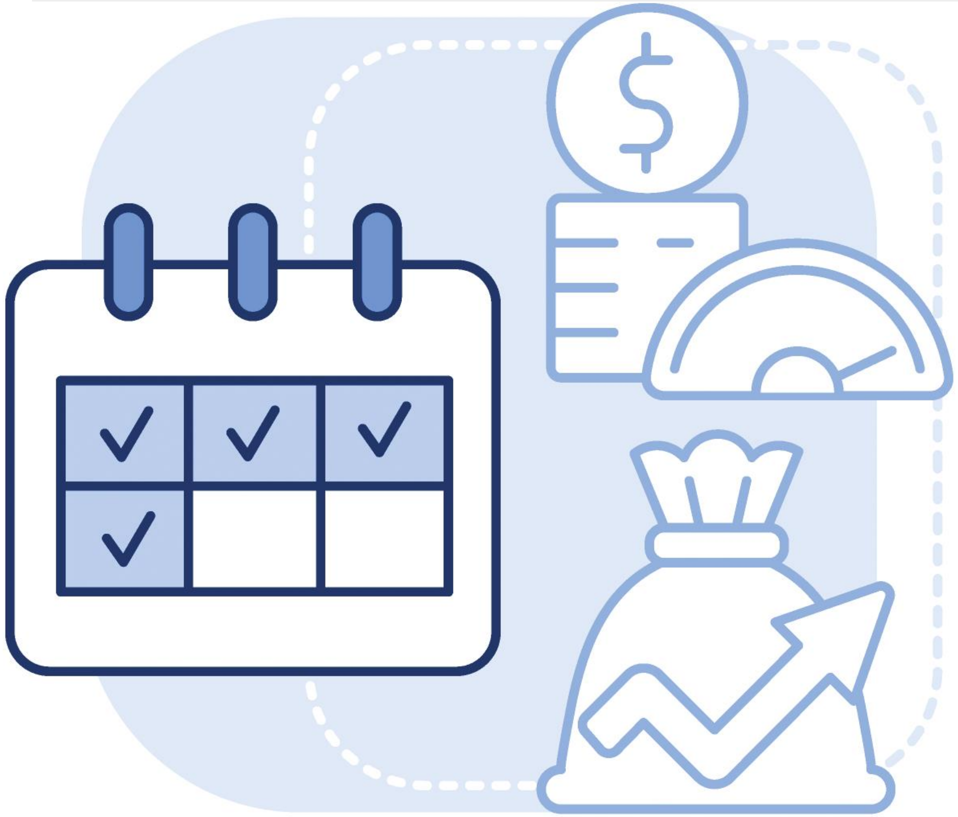


Solvency vs. Liquidity

As a general rule, a company must always be solvent to inspire trust in its partners (bank, suppliers,…).

Being solvent reassures your partners because, in case of cessation of activity, the sale of your assets will allow you to repay all your debts.

Liquidity is also important because it allows you, if necessary, to pay all your short-term debts (supplier debts, negative bank balance for example) with resources that can be sold quickly.



Balance sheet example

Let's look at an illustrated example of what a balance sheet might look like.

An example of balance sheet

Low liquidity

LIQUIDITY

High liquidity

Low payability

SOLVENCY

High payability

ASSETS	€	LIABILITIES	€
Immaterial needs		Equity	
Material needs		Financial reserves	
Financial needs		Business results	
Stocks		Subsidies	
Debt claims		Bank debts	
Securities		Debts to suppliers	
Cash in bank		State debts (taxes e.g.)	

Payability

We have already seen what asset liquidity is. Now, let's look at the notion of payability.

The payability of your liabilities is defined as a situation that authorises a creditor to demand the immediate payment of all or part of the sums to be paid by the debtor.

To put it simply, let's take the case of business bankruptcy. The more liability is due, the greater the likelihood that a creditor will quickly claim the money you owe.

Chapter summary

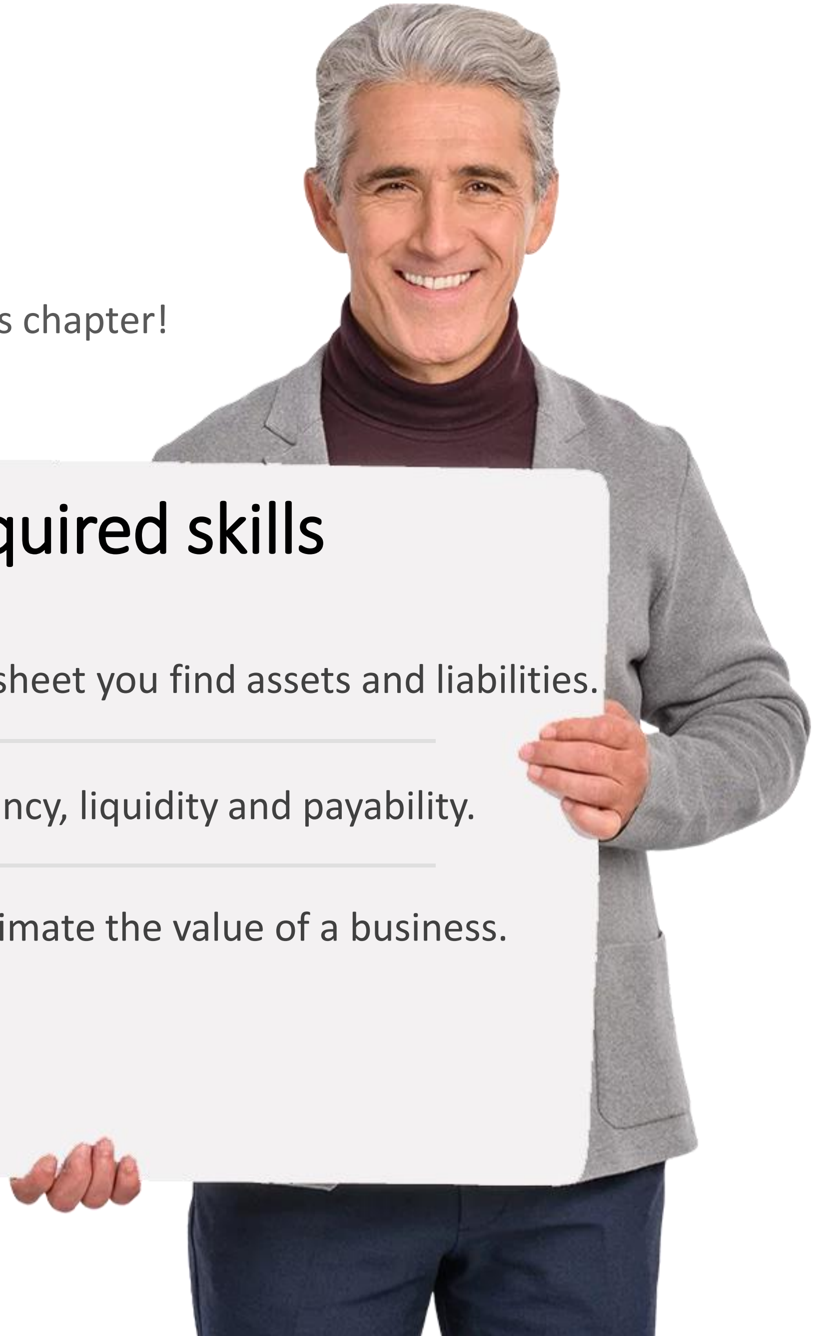
1. The balance sheet is a document that describes the company's assets and liabilities.

2. It is a tool to know the value of the company and ensure its solvency and liquidity.

3. Solvency is different from liquidity.

Chapter completed!

Congratulations! You have successfully completed this chapter!



Summary of acquired skills

1. In the balance sheet you find assets and liabilities.
2. It is about solvency, liquidity and payability.
3. It is used to estimate the value of a business.

What is next?

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Quiz

Click the **Quiz** button to edit this object

BUSINESS MODULE 6 Financial Forecasts

The financial forecasts are part of the business plan.

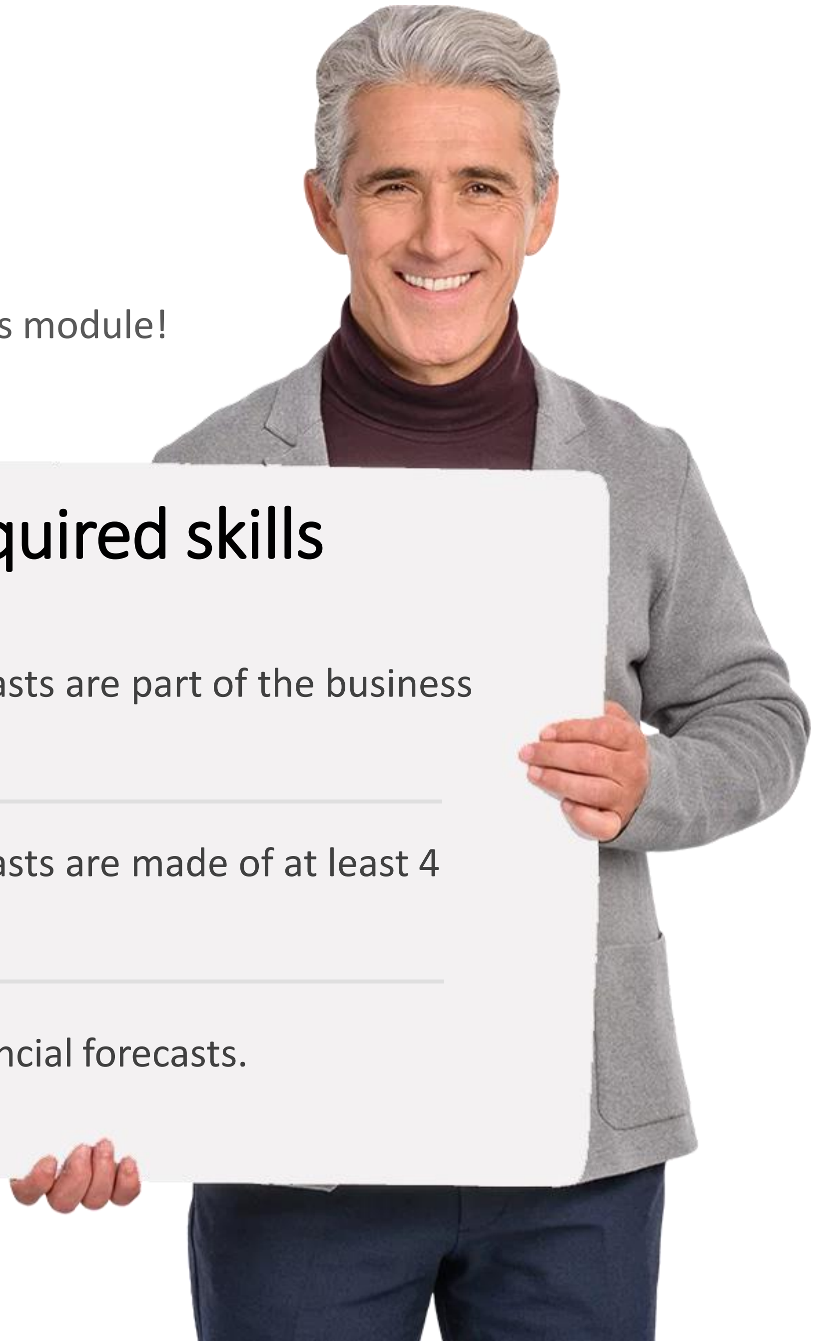
- True
- False

Module summary

1. Financial forecasts are part of the business plan.
2. Financial forecasts are tools like tables and charts.
3. There are 4 main financial tables.
4. Each table is used to calculate specific data.
5. These data are used as a roadmap.
6. The financial forecasts need to be coherent with the global scenario.

Module completed!

Congratulations! You have successfully completed this module!



Summary of acquired skills

1. Financial forecasts are part of the business plan.
2. Financial forecasts are made of at least 4 tables.
3. How to do financial forecasts.

What is next?

Now you can either repeat this module or follow our study recommendation by clicking on one of the buttons below:

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