Financial Planning

Businesses need to manage and measure their financial performance and check important indicators of their financial 'health'. It is vital that they know what their revenue and costs are if they want to see how much profit they are making. Businesses regularly measure their profit to monitor their progress.

It is essential that businesses measure their profitability to see how much profit they are making and determine whether or not their business is successful.

There is an essential distinction between profit and revenue; profit is not the same as revenue. Revenue is the amount of money a business receives from its sales however, the business has to deduct its own costs from the revenue and the sum that is left is actually the profit. If the business has costs which are greater than its turnover, instead of making a profit it will make a loss.

Mostly all businesses exist to make a profit.. One of the ways businesses can improve their profits is by increasing their prices if the demand for their product is price inelastic, or even by reducing their prices to increase demand if the demand for their product is price elastic. During the first few months of trading, if I increase the prices of my cakes and charge relatively high prices, this will have a rather negative impact on my business as my business will be very new and high prices will not attract customers it will instead most likely put them off from visiting my shop.

As well as measuring profitability it is also important for businesses to measure their liquidity (solvency). Liquidity is the ability of a company to convert its assets into cash. A business that cannot pay its creditors on time, cannot continue to meet its obligations to the suppliers of credit, services, and goods can go bankruptThe business could miss out the incentives given by the suppliers of credit, services, and goods if it is short of cash or liquid assets. Loss of such incentives may result in an increase in the cost of goods consequently affecting the profitability of the business.

The stake holders of a business also have an interest in the liquidity position of the business. Lenders of money will check the liquidity o f the business to be assured that the loan repayments will be paid on time. Suppliers of goods w ill also check the liquidity of the business before selling goods on credit.

Employers will also have an interest in the liquidity of the business, they will want to know If the business will be able to meet their needs e.g. salary, pension.

Assets

Assets are things that a business owns. Business assets can be divided into two categories: fixed assets and current assets.

Fixed assets are long term; they tend to have a life-span of more than one year. Examples of fixed assets include premises, machinery and equipment. They are usually shown in the top half of the balance sheet, and the current liabilities are subtracted from them to show net current assets.

Current assets are short term; less than a year. They can be quickly realised and changed frequently. The main current assets include stock, debtors and cash.

Liabilities

Liabilities are things that businesses owe. There are two types of liabilities: current liability and long term liability.

Current liabilities are short term debt for a business. They include an amount that can be paid off within a year. These liabilities may include overdraft repayments, wages, trade creditors, and expenses such as electricity/gas/water.

Long term liabilities are the items that a business intends to keep for longer than a year. These liabilities do not require interest payments during the current year. They could include bank loan or mortgage.

Expenses

Business expenses are the cost of carrying on a business. Every business incurs expenses. These expenses might include: the rent of premises, utility, advertising costs, insurance, interest on loan, motor expenses and depreciation. These expenses are usually deductable and can reduce your tax liabilities.

Cash flow Forecasts

Cash flow forecasts are statements that show the amount of money that is predicted to come into and flow out of the business over a period of time. It is therefore useful for a business to make a cash flow forecast because it aids them in making decisions. However, cash flow forecast do have some weaknesses the main one being that they are not always accurate because they are based on assumptions. As cash flow forecasts are based on predictions about whats going to happen, a false forecast can have an extremely negative effect on a business because if it runs out of money it may go bankrupt. Good cash flow forecasting needs experience and research into the market.

Break-Even

Break- even is a useful planning tool as it provides business with information on what volume of sales is needed to cover its cost. This is known as the break-even point. When sales are below the break-even point the business makes a loss. However when sales are above the break- even point, the business makes a profit.

Break- even analysis can also help to analysis the impact of a change in the environment on the business. It can also help in deciding whether or not it is feasible to accept an order for products at a different price from normal.

However break- even analysis can be a lot more complicated for business that sell a variety of different products. The analysis is based on assumptions that everything produced is sold whereas it is often the case that not all output will be sold.

Profit & loss Account

All companies are legally obliged to produce a trading profit & loss account. The profit and loss account covers all of your business trading activity over a period of time, usually twelve months. It shows how much the business has earned form selling its product or service, and how much it has paid out in costs (production costs, salaries, etc).

Profit and loss account is important to my business as it will show me the performance of my business and will indicate whether the business has made a profit or loss over the year. It will also help me to work out the amount of tax I will need to pay.

Profit and loss account is an essential financial tool for the business, as its stakeholders have an interest in the financial status of the business. For

example employees would be interested in the amount of profit the business is making, as an indicator of job security and potential pay rises. Shareholders would also want to know the business's operating profit because they would like to get as much dividend as possible.

However profit and loss account can be manipulated to paint a better picture of the business which can be misleading. The financial data included is not adjusted for price changes, impact on the business's performance due to a change in the environment e.g. inflation.

Profit and loss will be very useful to my business as it will enable me to pay the correct amount of tax. I can also compare my Profit and loss forecast with the actual performance of other companies- preferably a competitor, to see which aspect of my business needs to be considered more seriously.

Balance Sheet

The profit and loss account only shows part of the picture. It may show an excellent profit but at the same time, the company may have burdened itself with debt. The balance sheet shows the current health of the business as measured in terms of its assets and liabilities. A balance sheet shows how solvent the business is, and how liquid its assets are. It shows whether the business has the ability to meet its short term obligations, as well as paying all current and long term debts.