New Venture Creation: NCV Level 2
Module 3
Financial requirements of a new venture
In Module 3 we shall be covering:

- how to determine the income & expenditure of a new venture
- how to determine the financial and cash flow requirements of the new venture
- how to implement pricing and costing principles
- identifying the resources to obtain start-up capital
Can the new venture make money from its product choice?

Product choice

Product price

Product cost
Important financial questions to answer first

- What are all the costs involved in the proposed new venture?
- What is the break-even point of this new business?
- In which way can the proposed new business be financed?
- What is profit, how is it calculated and how can a profit be made?
- How much do the products of the new business actually cost?
- How much do competitors charge for the same products?
What make up the Income & Expenditure of a new venture?

Sales
The products or services that a business sells to its customers for a particular period (e.g. for a day/week/month/year) in order to generate profits

Costs
The total costs of the business are made up of:
* Variable Costs* which vary according to sales volumes
* Fixed Costs* which stay the same regardless of changes in sales

Income & Expenditure

Profit
The money left over in the business after ALL costs have been deducted from total sales
Understanding business terminology

These are also called ……

Sales

turnover
income
revenue

Costs

expenses

Profits

net income
Because costs are deducted from sales, profits will always be LESS than sales.
Getting to the Sales figure

The sales figure is arrived at by multiplying the selling price (SP) by the number of units sold. For example:

\[ \text{SP} \times 100 = R\ 50\ 000 \]
Variable and Fixed Costs

Variable costs \textit{increase} as sales increase

Fixed costs \textit{remain constant}
**Examples of fixed and variable costs**

<table>
<thead>
<tr>
<th>Fixed Costs</th>
<th>Variable Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>• rent</td>
<td>• raw materials</td>
</tr>
<tr>
<td>• salaries</td>
<td>e.g. cloth, buttons, thread for shirts</td>
</tr>
<tr>
<td>• electricity</td>
<td>• direct labour</td>
</tr>
<tr>
<td>add your own:</td>
<td>add your own:</td>
</tr>
<tr>
<td></td>
<td></td>
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</tbody>
</table>
Getting to the Profit figure

Sales

Less: Cost of Sales

= Gross Profit

Less: Expenses

= Net Profit

Variable costs

Fixed costs
For example:

<table>
<thead>
<tr>
<th></th>
<th>R</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>1 000</td>
</tr>
<tr>
<td><strong>Less: Cost of Sales</strong></td>
<td>500</td>
</tr>
<tr>
<td>= Gross Profit</td>
<td>–500</td>
</tr>
<tr>
<td><strong>Less: Fixed Expenses</strong></td>
<td>200</td>
</tr>
<tr>
<td>= Net Profit</td>
<td>–300</td>
</tr>
</tbody>
</table>
## Calculating Profit %

### Gross Profit %

\[
\text{Gross Profit} \% = \frac{\text{Gross Profit}}{\text{Sales}} \times 100
\]

\[
= \frac{R\ 500}{R\ 1000} \times 100 = 50\%
\]

### Net Profit %

\[
\text{Net Profit} \% = \frac{\text{Net Profit}}{\text{Sales}} \times 100
\]

\[
= \frac{R\ 300}{R\ 1000} \times 100 = 30\%
\]
## The Weighted Average Gross Profit % (WAGPP)

### Example: Retailer selling milk and bread

<table>
<thead>
<tr>
<th>Product</th>
<th>(1) % of Sales</th>
<th>(2) Gross Profit % per product</th>
<th>(3) Weighted Gross Profit % (1) x (2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>milk</td>
<td>65 %</td>
<td>29 %</td>
<td>19 %</td>
</tr>
<tr>
<td>bread</td>
<td>35 %</td>
<td>33 %</td>
<td>12 %</td>
</tr>
</tbody>
</table>

Therefore the WAGPP is:

\[
19 \% \text{ (milk)} + 12 \% \text{ (bread)} = 31 \%
\]
A **Budget is:**

- a detailed financial plan of what is most likely to happen in the future
- always for a specific time period (normally 1 year)
- reviewed at regular intervals (normally every month) to compare actual performance against the budget
- drawn up for each key function of the business
  - a sales budget
  - a production budget
  - a materials budget
  - a labour budget
  - an administration budget
Key questions to ask when drawing up the Sales Budget

- **Market size**
  How big is the potential market?

- **Competitor analysis**
  How many and what type of products are my competitors selling?

- **Market Research**
  How many people are likely to buy the product or service offered by the new business?

- **Financial Research**
  How many products does the business need to sell so that it doesn’t make a loss?
## Format of the Sales Budget

### Sales Budget

<table>
<thead>
<tr>
<th>Months</th>
<th>Jul</th>
<th>Aug</th>
<th>Sep</th>
<th>Oct</th>
<th>Nov</th>
<th>Dec</th>
</tr>
</thead>
<tbody>
<tr>
<td>Forecast unit sales</td>
<td>500</td>
<td>800</td>
<td>1200</td>
<td>1200</td>
<td>1500</td>
<td>300</td>
</tr>
<tr>
<td>Selling price per unit</td>
<td>R 8</td>
<td>R 8</td>
<td>R 8</td>
<td>R 8</td>
<td>R 8</td>
<td>R 8</td>
</tr>
<tr>
<td>Sales Budget (R)</td>
<td>4000</td>
<td>6400</td>
<td>9600</td>
<td>9600</td>
<td>12000</td>
<td>2400</td>
</tr>
</tbody>
</table>

**6 months Sales Budget = R 44 000**
The benefits of budgeting

**Budgeting helps the owner of the new venture to:**

- control expenditure by planning before committing funds to spend
- provide targets that actual results can be compared with
- coordinate all business activities by integrating all functional budgets
- effectively utilise resources in the best way
- determine business objectives in terms of money
- evaluate the performance of different departments against budget standards
The Assets of a business

Fixed Assets
- Long-term
- Short-term

Current Assets
- Cash
- Debtors
- Stock
The Liabilities of a business

Long-term Liabilities
- Shareholders
- L-term Loans

Current Liabilities
- Overdrafts
- Creditors
- Tax
The Break-even point of a business

Break-even point

Fixed Costs
Variable Costs
Sales
For example:

Selling price per unit  
\[ \text{R} \] 50

Less: cost price per unit  
\[ \text{R} \] 30

= gross profit per unit  
\[ \text{R} \] 20

If fixed costs are  
\[ \text{R} \] 2000

then the Break-even point  
\[ \text{R} \] 20

= 100

i.e. the business has to sell 100 units to cover its fixed costs
Checking the Break-even calculation

Sales: 100 units @ R 50 per unit = 5000
Cost of Sales: 100 units @ R 30 per unit = 3000
Gross Profit: = -2000

If fixed costs are 2000

then gross profit (R 2000) – fixed costs (R 2000) is 0

i.e. the business has sold 100 units to cover its fixed costs and is now in a position to start making a “net profit”
What about the Break-even value?

Selling price per unit  R 50

Less: cost price per unit  R 30

= gross profit per unit    R 20

Gross profit %  =  \( \frac{R 20}{R 50} \times 100 \)

= 40 %

Break-even value  =  R 2000

= 40 %

=  R 5000
Checking the Break-even value calculation

Sales: 100 units @ R 50 per unit = 5000

Gross Profit: 40 % of R 5000 = 2000

If fixed costs are 2000

then gross profit (R 2000) – fixed costs (R 2000) is 0

i.e. the business has sold R 5000 to cover its fixed costs and
is now in a position to start making a “net profit”
# The ‘once-off’ start-up costs of a business

<table>
<thead>
<tr>
<th>Fixed Assets</th>
<th>Pre-operating Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>• land &amp; buildings</td>
<td>• telephone</td>
</tr>
<tr>
<td>• machinery</td>
<td>• answering machine</td>
</tr>
<tr>
<td>• vehicles</td>
<td>• vacuum cleaner</td>
</tr>
<tr>
<td>• furniture</td>
<td>• counters</td>
</tr>
<tr>
<td>• tools</td>
<td>• kitchen equipment</td>
</tr>
<tr>
<td>• cash register</td>
<td>• cell phones</td>
</tr>
<tr>
<td>• scale</td>
<td></td>
</tr>
<tr>
<td>• computers</td>
<td></td>
</tr>
</tbody>
</table>
The Cash-flow Statement deals with:

- the money coming IN and the money going OUT
- helping the business to prevent cash shortages
- the percentage of sales for cash and those on credit
- the cash payments due to suppliers
- the cash required to pay monthly fixed costs
## The Forecast Cash-flow Statement

<table>
<thead>
<tr>
<th>Months</th>
<th>Jul</th>
<th>Aug</th>
<th>Sep</th>
<th>Oct</th>
<th>Nov</th>
<th>Dec</th>
</tr>
</thead>
<tbody>
<tr>
<td>Money in bank (R)</td>
<td>1 000</td>
<td>1 800</td>
<td>2 600</td>
<td>-1 600</td>
<td>12 000</td>
<td>19 600</td>
</tr>
<tr>
<td>CD sales (R)</td>
<td>30 000</td>
<td>30 000</td>
<td>30 000</td>
<td>60 000</td>
<td>45 000</td>
<td>45 000</td>
</tr>
<tr>
<td>DVD sales (R)</td>
<td>2 500</td>
<td>2 500</td>
<td>2 500</td>
<td>5 000</td>
<td>5 000</td>
<td>7 500</td>
</tr>
<tr>
<td><strong>Total Cash IN (R)</strong></td>
<td><strong>33 500</strong></td>
<td><strong>34 300</strong></td>
<td><strong>35 100</strong></td>
<td><strong>63 400</strong></td>
<td><strong>62 000</strong></td>
<td><strong>72 100</strong></td>
</tr>
<tr>
<td>CD cost of sales (R)</td>
<td>18 000</td>
<td>18 000</td>
<td>18 000</td>
<td>36 000</td>
<td>27 000</td>
<td>27 000</td>
</tr>
<tr>
<td>DVD cost of sales (R)</td>
<td>1 700</td>
<td>1 700</td>
<td>1 700</td>
<td>3 400</td>
<td>3 400</td>
<td>5 100</td>
</tr>
<tr>
<td>Other costs (R)</td>
<td></td>
<td></td>
<td></td>
<td>5 000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed costs (R)</td>
<td>12 000</td>
<td>12 000</td>
<td>12 000</td>
<td>12 000</td>
<td>12 000</td>
<td>12 000</td>
</tr>
<tr>
<td><strong>Total Cash OUT (R)</strong></td>
<td><strong>31 700</strong></td>
<td><strong>31 700</strong></td>
<td><strong>36 700</strong></td>
<td><strong>51 400</strong></td>
<td><strong>42 400</strong></td>
<td><strong>44 100</strong></td>
</tr>
<tr>
<td><strong>Closing balance (R)</strong></td>
<td><strong>1 800</strong></td>
<td><strong>2 600</strong></td>
<td><strong>-1 600</strong></td>
<td><strong>12 000</strong></td>
<td><strong>19 600</strong></td>
<td><strong>28 000</strong></td>
</tr>
</tbody>
</table>
### Keeping financial records

<table>
<thead>
<tr>
<th>Source documents</th>
</tr>
</thead>
<tbody>
<tr>
<td>These documents are essential in order to compile proper financial records of all business transactions</td>
</tr>
<tr>
<td>Examples are:</td>
</tr>
<tr>
<td>• receipts</td>
</tr>
<tr>
<td>• sales invoices</td>
</tr>
<tr>
<td>• delivery notes</td>
</tr>
<tr>
<td>• bank deposit slips</td>
</tr>
<tr>
<td>• petrol slips</td>
</tr>
<tr>
<td>Proper financial records are required to compile proper financial statements that explain the financial position of the business</td>
</tr>
</tbody>
</table>
The 3 Key Financial Statements

- Income Statement
- Balance Sheet
- Cash-flow Statement
Factors influencing pricing

Target market
- What is the price that the identified target market will accept?

Competitors
- What prices are direct competitors charging for their products?

Convenience
- How much more are customers willing to pay for convenience?

Costing
- Does the selling price cover all costs and leave enough for profits?
Skimming
A high introductory price is set to recover R & D costs

“Loss leader”
The prices of a few popular products are reduced to entice customers to buy

Competitive pricing
The price is set just below the price of competitors

Odd pricing
Pricing is set at a level which sounds a lot less e.g. R19-99 vs. R20-00

Cost-plus pricing
The cost of each product is calculated and then a mark-up is calculated

Pricing Concepts

Final price
Calculating the % ‘Mark-up’

To calculate Gross Profit % we know the formula is:

\[
\frac{\text{Gross Profit}}{\text{Sales}} \times 100
\]

e.g. \( \frac{\text{R 4 / unit}}{\text{R 10 / unit}} \times 100 = 40\% \)

BUT calculating the Mark-up % uses the formula:

\[
\frac{\text{Gross Profit}}{\text{Cost of Sales}} \times 100
\]

e.g. \( \frac{\text{R 4 / unit}}{\text{R 6 / unit}} \times 100 = 66.7\% \)
Costing principles for various types of business

Units sold / month less the cost price / unit
- stock
- transport
- sales commission

Units produced / month less the cost price / unit
- raw materials
- direct labour
- power e.g. electricity

Service hours / month less the cost price / hour
- material used
The procedure for compiling cost prices

Step # 1: determine all potential variable costs per product/service
Step # 2: add up all potential fixed costs for a month
Step # 3: add up all start-up costs (also calculate monthly repayments)
Step # 4: add the loan repayment amounts to monthly fixed costs
Step # 5: compile a monthly sales forecast
Step # 6: multiply variable cost per product/service by the sales forecast
Step # 7: add up all the variable and fixed costs to determine total monthly costs
In a trading business you buy chickens for R 9 each.
You buy 200 chickens at a time and pay R 200 for the transport i.e. R 1 each.

**Variable costs are:**
- R 9-00 (chickens for re-sale)
- plus R 1-00 (transport costs per chicken)
- \[= R 10-00 \text{ per chicken}\]

**Fixed costs are:**
- R 200-00 (telephone)
- plus R 300-00 (rent)
- plus R 1 500-00 (salaries)
- \[= R 2 000-00\]

If you sell the chickens for R 20 each and expect to sell 600 chickens per month then the sales will be R 12 000, the variable costs will add up to R 6 000 (600 x R 10) and the fixed costs will remain R 2 000.

**TOTAL MONTHLY COSTS =** R 8 000-00 (variable + fixed costs)
Financing the business: Capital requirements

- **Start-up capital** to buy fixed assets
- **Working capital** to pay for stocks & operating expenses
- **Growth capital** to finance expansion
Funding options to start a business

Financial requirements
- start-up capital
- working capital
- growth capital

Equity
- Own funds
- Family and friends
- Shares

Borrowed Capital
- Short-term loans
  - bank overdraft
  - trade credit
- Long-term loans
  - bond
Using Financial Institutions

**Banks**
- current accounts
- savings accounts
- internet banking
- telephone banking
- auto-banking

**Other Institutions**
- Khula
- Business Partners
- Micro lenders
- Chambers of Commerce
but ... BEFORE you start your own business ...