Small bussines

Finance

RUNNING HEAD: Finance and Accounting Finance and Accounting - Small Business of This paper seeks to write a report about the projected financial statements of a proposed business, the capitalization of which would come from four partners at $80, 000 each or a total of $320, 000. This will evaluate the financial information for the next three years if the benefits will justify the cost of going into business. Since the financial statements are meant for the future for the purpose of evaluating the feasibility of the proposal this report will discuss about the profitability of the venture that would have to be supported with good liquidity and acceptable solvency or financial leverage.

As can be seen from Appendix A, the business will have losses for the first two years but beginning in the third year profitability will become positive and the following years thereafter. However this paper will report only the first three years. The higher expenses than revenues in the first two years are understandable as the business is just starting. Sales revenues will expand over time with higher sales volume into new locations as the branded products of the business become known. The decreasing expenses starting after two years would come as the business take less expensive locations. This would result to increasing gross monthly margin overtime as can be seen in Appendix B.

Increasing sales is observable for the next three year period and such behavior should indicate growth of the business for the next three years. The greater the revenues the higher would be the changes for better profitability after deducting the expense (Bernstein, 1993; Droms, 1990). The profitability of the business is obvious the third year and as reflected in the positive net profit margin of 16. 7% after having negative rates for the past two years

because of the losses. See Appendix C.

Profitability essentially means higher revenues than expenses which would mean that the business would naturally incur cost or expenses in running the business but the same should generate higher revenues in exchange of the expenses to indicate profitability of the business.

The profit generated by the business is not enough to assure that business will prosper. The business must be able to pay its maturing obligations on time like the salaries of employees, payment for goods and services to supplies, regular bills for electricity, telephone and other utilities. In other words, it must have sufficient working capital or excess of current assets over its current liabilities at one point in time which can be measure also by liquidity ratios (Helfert, 2001). The company is found liquid for the next three years as could be seen from the positive current ratio and quick asset ratio ratios. The company was able to maintain good liquidity ratios for the first three years although it declined over the years because of the losses in the first two years which were not strong enough to endanger to company to become bankrupt as the company still exhibited 1. 34 current ratio year 3, which means that it has higher current assets than current liabilities.

Good liquidity ratios are an assurance of a companys ability to meet its currently maturing obligations (Gitman, 2006; Helfert, 2001). No company can operate normally if salaries payable, accounts payable and other accrued expenses are not settled on time. The moment that working capital becomes negative becoming insolvent would bring greater problem if the bankruptcy sets. Sometimes, it could mean closure of business as the extreme possibility. Moreover, the high positive cash flows are year ends for three are very reassuring. See Appendix F.

Aside from profitability and liquidity, a business needs to be solvent or that it should have a long-term health (Kieso, et al, 2007; Higgins, 2007) to survive temporary tsunamis in the economy. Such solvency or financial leverage is normally measured by relating the level of total debt to total assets. The company was found to a debt to asset ratio at below 75% in year 3. See Appendix E. Such level is still acceptable in the absence of an industry ratio that will tell that it is too high in relation with competitors. Since this paper merely talks of three years, the profitability is assumed to continue for longer years to enable the owners to recover their investment. As of the end of the third year, the total capital was of the owners was lower than the invested amount of $320, 000 at the start because of the losses of two years and not so big profit for the third year. See Appendix D. Since the company is assumed to have solvency, with continued profitability for the years after the third year and beyond, the owners would be recovering their investment and earn profits.

Appendices

Appendix A; Source (Hoyle, Schaefer, & Doupnik, 2011)

Appendix B; Source (Hoyle, Schaefer, & Doupnik, 2011)

Appendix C – Profit and Loss; Source (Hoyle, Schaefer, & Doupnik, 2011)

Appendix D – Balance Sheet; Source (Hoyle, Schaefer, & Doupnik, 2011)

Appendix E- Ratios; Source (Hoyle, Schaefer, & Doupnik, 2011)

Appendix F- Cash Flows; Source (Hoyle, Schaefer, & Doupnik, 2011)

References:

Bernstein, J. (1993). Financial Statement Analysis, Sydney: IRWIN

Droms (1990). Finance and Accounting for Non-Financial Managers. England: Addison-Wesley Publishing Company

Gitman, L. (2006). Principles of Managerial Finance. New York: Addison Wesley

Helfert, E. (2001). Financial Analysis: Tools and techniques: a guide for managers. McGraw-Hill Professional

Higgins (2007). Analysis for Financial Management, Eighth Edition. The McGraw−Hill Companies

Hoyle, J., Schaefer, T., & Doupnik, T. (2011) Advanced Accounting (10th ed). McGraw-Hill Irwin Publishing.

Kieso, et al (2007). Intermediate Accounting. John Wiley and Sons