

# Business finance

## a practical guide



BUILDING YOUR KNOWLEDGE

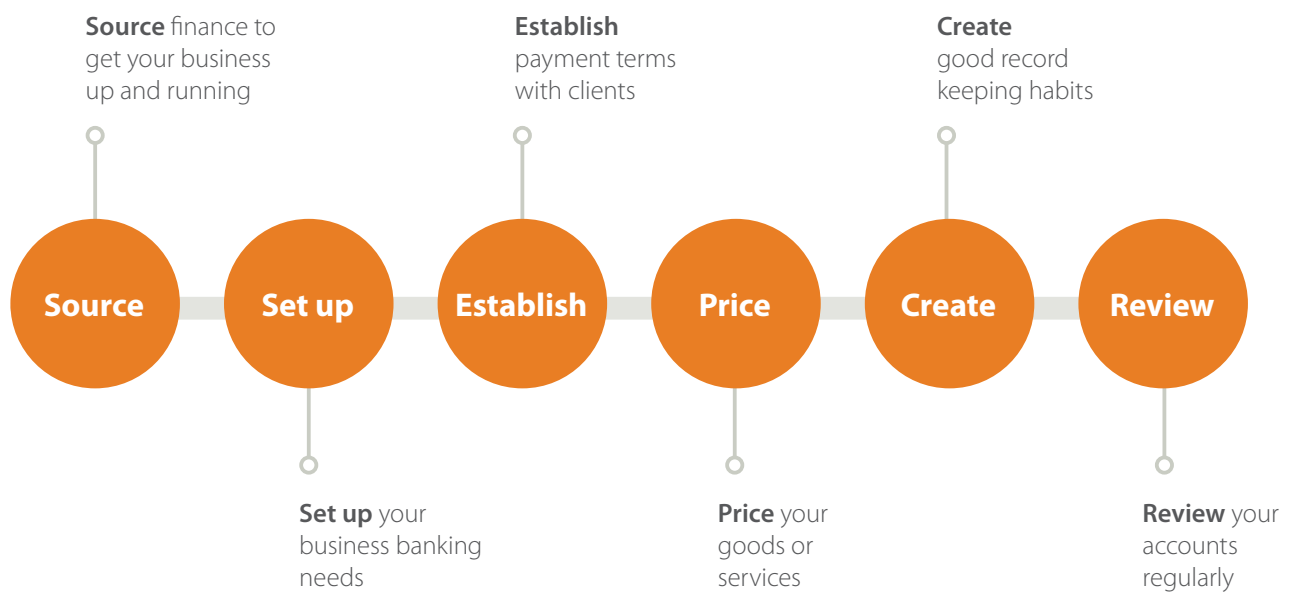


Small Business  
Development Corporation

13 12 49  
[smallbusiness.wa.gov.au](http://smallbusiness.wa.gov.au)  
*The small business specialists*

# A practical guide to business finance

An essential part of being a small business owner is knowing how to set up and manage your business finances. Finance is more than just money; it is the foundation of your business. Understanding your finances will help generate income, plan future growth, meet legal obligations and maximise profits.



## Sourcing finance

When applying for business finance it's essential to be prepared. Most lenders want to check the viability of your business to ensure they will get their money back and also to provide you with the right type of finance and advice. Every financial institution has its own criteria for assessing applications; however most will make an initial assessment based on the three Cs:

- **character** - your past business performance, skills and credit history;
- **cash flow** - the expected cash in and out of the business (it should be realistic and show sufficient funds can be generated to cover any loans); and
- **collateral** - what you are offering as security against any potential loss by the lender.

The following steps outline the information needed to help you secure finance.

## 1. Develop a comprehensive business plan

A detailed plan will help you prove the feasibility of your business idea to potential lenders. It should provide an overview of the products or services you will be offering, your operations, realistic financial projections and how you will differ from your competition.

It is important to state whether you are planning to buy a business or start from scratch. The information provided must be realistic and logical. You must clearly show the viability of your business and answer these five key questions about borrowing money:

1. How much will you need?
2. What will you do with it?
3. When will you repay it?
4. How will you repay it?
5. What can you offer as security?

To help you draft a business plan, attend the SBDC's '12 Step Business Planning' workshop. Visit [smallbusiness.wa.gov.au](http://smallbusiness.wa.gov.au)



**Be realistic about how much money you will need to start your business, especially if you are seeking finance. Lending institutions may lose confidence in your business if you come back for more money too quickly.**

## 2. Calculate how much you need to borrow

Use the table below to work out how much money you need to start or buy a business.

How much money do I have to invest in this business?	
Personal savings	\$
Grants	\$
Investors	\$
Other	\$
<b>Total</b>	<b>\$</b>

How much money do I need to start or buy this business?	
Business purchase price (if applicable)	\$
Advertising and promotion	\$
Expenses related to leased premises (rent in advance, utilities, bond etc.)	\$
Fit-out of premises	\$
Initial stock	\$
Insurance	\$
Licences and permits	\$
Office supplies (computer, printing, stationery)	\$
Plant and equipment (shelving, machinery, vehicle)	\$
Professional advisory costs (lawyer, accountant)	\$
Research costs	\$
Staff costs	\$
Other	\$
<b>Total</b>	<b>\$</b>

If the money you need doesn't match the money you have you will need finance for the difference.

## 3. Shop for loans

Shop around and compare the many options for securing finance, including financial institutions, family and friends, government grants and crowd funding.

### Financial institutions

Borrowing funds from a financial institution will incur costs and charges. They will vary but are likely to include:

- interest rates
- flexible payment terms
- application fees
- ongoing fees and charges
- insurance costs

### Family and friends

If you have limited equity and minimal business management experience, then family and friends may provide finance to get your business up and running. However, it is wise to sign a professionally drafted agreement which details the requirements of the loan including how and when repayments will be made.

### Government grants

There are very few government grants to assist with starting a small business. However industry specific grants, for example for the textile industry or arts, may be available. Generally, government support is available through programs and initiatives, such as the free services provided by the SBDC. Information about government grants and programs can be found at [business.gov.au](http://business.gov.au)

### Crowdfunding

This method of raising finance involves using online networks to bring large numbers of people together and generate project funding in exchange for goods, services or equity. This works best if you have a strong online presence and have a business that can offer rewards to encourage the public to invest. An internet search will direct you to a range of networks.



## Setting up business banking

It is recommended to always keep business accounts separate from your personal ones. Setting up a business bank account is relatively quick and easy, but be clear about your needs, for example:

- Do you need merchant facilities (EFTPOS terminal or online payment options)?
- Are you likely to need an overdraft?
- How many of your sales will be cash, debit or credit card?
- Do you need a cheque account?
- Will you need to physically deposit cash takings at the end of a work day?

### Merchant facilities

These give customers the option of paying by credit or debit card. However, take the time to research the associated costs. For some online businesses it may be more beneficial to use an online third party payment system rather than set up merchant facilities. There are also additional costs associated with having a physical terminal (EFTPOS).

## Establishing your payment terms

It is in your best interest to create payment terms with both suppliers and customers that ensure you have adequate cash flow to meet your financial obligations.



- **Make sure your payment terms are clearly displayed on all invoices.**
- **Set up long payment terms with your suppliers, for example 30 days, and short payment terms with your customers of seven to 14 days.**
- **If offering a significant level of credit to customers, check their credit history first using one of the many online tools available.**

### With your suppliers

Negotiate payment terms which will help you manage your cash flow. Ask suppliers to:

- extend payment terms from 30 to 45 days; or
- allow you to pay quarterly (particularly utility companies); and
- start the payment term from the date of complete delivery, not part delivery.

If you have to return goods make sure the supplier provides a new invoice.

Establish an accounts control system so your suppliers are not:

- paid earlier than necessary
- overpaid – check the goods you receive match your original purchase order and the totals on the invoice

- paid twice – pay only on a supplier's invoice, not the statement

### With your customers

Set up clearly defined payment terms which favour your financial needs, for example immediate payment, or within seven to 14 days of the invoice date. When setting your payment terms make sure they are clear and consider:

- method of payment
- credit limits
- early payment incentives

If your business will be offering credit to customers, reduce your exposure to risk by conducting credit checks and asking customers to pay part of the invoice before receiving the goods or service. Many businesses ask for cash on delivery until a firm relationship has been developed with customers.



**Tax law requires you to keep a record of your debtors (people or businesses who owe you money). Good record keeping helps you to better track and manage your debtors. See our tips in 'Creating good record keeping habits'.**

## Pricing your goods and services

It is important to correctly price your product or service to ensure you cover all your costs, make a profit and stay competitive. This is a key step in determining the overall financial viability of your business. There are four key elements to consider when pricing:

### 1. Cost of goods sold (COGS)

Calculate the exact cost of getting your product or service to market. Factor in wholesale prices, shipping and assembly costs.

Visit [smallbusiness.wa.gov.au](http://smallbusiness.wa.gov.au) and download the 'Cost of goods sold' calculator to help you.

### 2. Expenses (or overheads)

Your expenses (overheads) are all the other costs you incur in running a business, including marketing, bank fees, electricity, rent, employing staff etc. Remember you have to price your products or services to cover COGS and ongoing expenses.

### 3. Profit

In addition to covering your COGS and expenses you also need to make a profit. You need to determine what level of profit you aim to make and mark-up your products or services accordingly.

### 4. Competition

The final element to consider is competition. Your prices must be comparable with your competitors and in line with what customers are willing to pay.

Never assume your competition has their pricing right; research why they are charging these prices. You can get a feel for how your business would perform against the Australian average by consulting the ATO's small business expected income benchmarks at [ato.gov.au](http://ato.gov.au)

If you plan to offer a more costly product or service than your competitors, it's important to communicate the reasons why to your customers e.g. quality, cost savings, after sales service, experience. It must relate to something that customers are willing to actually pay more for.



**Take note: if your current or expected annual turnover is \$75,000 or more, you must register for GST.**

## Creating good record keeping habits

There are two types of record keeping; financial and business.

### Financial record keeping

For any transaction with a financial element keep:

- copies of invoices and receipts you provide for goods sold or services rendered
- invoices for goods or services you purchase, or bills you pay for rent, rates, insurance, licence fees etc.
- records of payments to employees and to other organisations on behalf of employees e.g. superannuation funds, PAYG tax
- financial statements including profit and loss statements and balance sheets
- tax return information
- bank account and credit card statements; and
- end of year inventory records (including stock and assets)

Invoices laid out in a clear and consistent way, that include all the essential details, make it easier for customers and reduce the amount of time you spend chasing payment. For a guide on what you should be including in your invoices, visit [ato.gov.au](http://ato.gov.au) and search for 'how to set out tax invoices'.



**Good financial records management should include preparing a profit and loss budget and cash flow forecast, and using them for future business planning.**



## Business record keeping

In addition to the financial records requirements of the Australian Taxation Office (ATO), other government agencies also require you to keep records relating to your business and employees.

Your record keeping system should include:

- contracts, insurance agreements and other legal documents
- your commercial lease
- licences and permits
- employee records including timesheets, copies of pay slips etc.

- safety records e.g. risk assessment for occupational health and safety
- any other records that relate to your 'business activity' and are required by law for the operation of your business e.g. a food safety plan for your cafe.



**Under tax law your records must explain all transactions, be in writing, be in English and kept for five years (some need to be kept longer). Visit [ato.gov.au](http://ato.gov.au) for more details.**

## Reviewing your accounts regularly

The easiest way to monitor the financial health of your business is to regularly review your profit and loss (P&L) statement. A P&L statement shows your income and expenses over a specific period of time – whether you made or lost money.

There are five key figures in a P&L statement:

### 1. Sales (or revenue/turnover)

This includes the total income from your business operations for the sale of goods and services.

### 2. Cost of Goods Sold (COGS)

These costs are directly incurred as a result of buying or making the product. COGS are often referred to as variable costs as they are tied to the level of production or service.

### 3. Gross profit

This is the real income of your business. Gross profit is calculated before you subtract operating expenses such as wages, rent or insurance.

### 4. Expenses (or overheads)

Expenses are often called fixed costs because they are incurred regardless of the volume of activity the business undertakes. Expenses include wages, rent, marketing, accounting and legal fees, utilities and interest paid on loans.

### 5. Net profit (before tax)

Net profit shows what the business has earned (or lost) in a given period of time (usually monthly, quarterly, or annually) after both the cost of goods sold and operating expenses have been taken into account.

This final figure is what matters to financial institutions. Remember – having good sales doesn't necessarily mean your business is doing well; it's the net profit that puts money in your pocket.

## Use the following formula to calculate the five key figures you need



It is a good idea to monitor these figures regularly (at least monthly) to keep track of how your business is performing. Convert them to percentages and use tables and graphs to give you a quick visual overview.

The SBDC's 'Understanding business financials' workshop can assist you in making informed financial decisions about your business. Visit [smallbusiness.wa.gov.au](http://smallbusiness.wa.gov.au)

**Small Business Development Corporation**  
Level 2, 140 William Street, Perth WA 6000  
T: 13 12 49

[info@smallbusiness.wa.gov.au](mailto:info@smallbusiness.wa.gov.au) // [smallbusiness.wa.gov.au](http://smallbusiness.wa.gov.au) // [facebook.com/smallbusinesswa](https://facebook.com/smallbusinesswa)