Chapter Overview

INTRODUCE THE CHAPTER
This chapter tells how to identify and plan for the capital needs of a proposed business by developing the financial section of a business plan. It discusses estimating start-up costs and personal financial statement. It explains the need for and preparation of an income statement, balance sheet, and cash flow statement.

BUILD BACKGROUND
Work with the class to develop a sample personal budget for a college student for one month, listing their assets and their liabilities, or debts. Encourage students to make rough estimates of the costs of tuition, rent, food, and bills, as well as per month income and the value of assets such as a car. Tell students that this information can be used to prepare a personal financial statement.

Market Talk
Ask students if they think it is better to overestimate or underestimate expenses in the financial plan section of a business plan. Have them defend their reasoning.

Quick Think
Answers might include accurate numbers, a repayment plan, a profitable margin, and a convincing marketing plan.

Ask students on whom they would rely to assist them in the preparation of the financial section of a business plan.

EXPLORE THE PHOTO
Market Talk
Starting a business requires more than a good idea and a good market analysis. Seed money is necessary for that idea to grow. That money, the capital, often has to be borrowed from commercial bankers, investors, and other lenders. To convince the lenders to lend you money, you need a good financial plan.

Quick Think
What do you think it takes to convince a lender to provide capital?

Develop a personal financial statement. The personal financial statement is a summary of your current personal financial condition.

Determine start-up costs for a business. Start-up costs are projections of how much money you will need for your first year of operation.

Estimate business income and expenses. Many small businesses fail because they do not bring in enough revenue to pay their costs and expenses. Lenders want to see your estimates to decide whether to lend you money.

Prepare an income statement. An income statement is a summary of income and expenses during a specific period such as a month, a quarter, or a year.

Create a balance sheet. A balance sheet is a summary of business’s assets, liabilities, and owner’s equity.

Interpret a cash flow statement. A cash flow statement is a monthly plan that tracks when you anticipate that cash will come into the business and when you expect to pay out cash. A cash flow statement helps you determine whether you will have enough money to pay your bills on time.
Discuss the performance indicators for the DECA events listed, so that students understand how to demonstrate their understanding.

The event acronyms stand for:

- **AAM**: Apparel and Accessories Marketing Series
- **ADC**: Advertising Campaign Event
- **ASM**: Automotive Services Marketing Series
- **BSM**: Business Services Marketing Series
- **EMDM**: E-Commerce Management Team Decision Making Event
- **FMAL**: Food Marketing Series, AL
- **FMDM**: Financial Analysis Management Team Decision Making Event
- **FMML**: Food Marketing Series, ML
- **HLM**: Hospitality and Recreation Marketing Research Event
- **MMS**: Marketing Management Series
- **QSRM**: Quick Serve Restaurant Management Series
- **RFSM**: Full Service Restaurant Management Series
- **RMS**: Retail Merchandising Series
- **SEM**: Sports and Entertainment Marketing Series
- **SMDM**: Sports and Entertainment Marketing Management Team Decision Making Event
- **TMDM**: Travel and Tourism Marketing Management Team Decision Making Event
- **TSE**: Technical Sales Event

**Performance Indicators**

The performance indicators represent key skills and knowledge. Relating them to the concepts explained in this chapter is your key to success in DECA competitive events. Keep this in mind as you read, and write notes when you find material that helps you master a key skill. In these DECA competitive events, you should follow these performance indicators:

- Explain the nature of overhead/operating costs
- Explain employee’s role in expense control
- Explain the concept of accounting
- Describe the nature of cash flow statements
- Explain the nature of balance sheets
- Describe the nature of profit-and-loss statements
- Describe the nature of budgets
- Describe the nature of business records

The events with an asterisk also include:

- Analyze cash-flow patterns
- Calculate financial ratios
- Interpret financial statements
- Analyze operating results in relation to budget/industry
- Develop expense-control plans
- Develop company’s/department’s budget

**DECA PREP**

**Role Play**

Check your understanding of DECA performance indicators with the DECA activity in this chapter’s review. For more information and DECA Prep practice, go to the Marketing Essentials OLC through glencoe.com.
SECTION 36.1

BELLRINGER ACTIVITY

Divide students into four groups, each one representing a type of business: manufacturing, wholesale, retail, or service. Give each group five to ten minutes to brainstorm a list of capital requirements for its start-up business.

Preteaching

VOCABULARY

KEY TERMS Ask students to write the key terms in their journal. Under each word, leave a few blank lines. They should write definition and example directly below the key term. On the definition line, ask students to write a phrase or two for the meaning of the word; on the example line, ask students to write a sentence using the world. When they come across the key word in the text, they can check their notes and rewrite their definitions or examples as necessary.

ACADEMIC VOCABULARY Refer students to the OLC through glencoe.com for the Academic Vocabulary Glossary before they read the section.

GRAPHIC ORGANIZER

Model using the graphic organizer for students. Tell students to go to the OLC through glencoe.com for a printable graphic organizer.

The Financial Part of a Business Plan

Financial information is a major component of a business plan. In your business plan, you will include financial documents that describe your personal finances as well as the financial needs of your business. By preparing financial statements, you will be able to determine the amount of money needed to operate the business as well as the amount that must be borrowed, if any.

OBJECTIVES

• Explain the purpose of financial documents
• Develop a personal financial statement
• Determine start-up costs for a business

THE MAIN IDEA

A key reason for writing a business plan is to obtain financing to start your business. It is important to prepare and include financial documents.

KEY TERMS

• personal financial statement
• asset
• liability
• net worth
• start-up costs

ACADEMIC VOCABULARY

You will find these words in your reading and on your tests. Make sure you know their meanings.

• assess
• purpose

ACADEMIC STANDARDS

English Language Arts
NCTE 1  Read texts to acquire new information.
English Language Arts
NCTE 3  Apply strategies to interpret texts.

Predict Why do you think it is necessary to develop personal and start-up financial statements?

The Financial Part of a Business Plan

Financial documents help to determine how much money can be made by the business.

Develop Concepts

THE MAIN IDEA

Ask students to think about all the possible categories they might expect to see on financial spreadsheets.

AS YOU READ

Explain that a personal financial statement shows your net worth and how you manage money; start-up costs show what it will cost to start the business.
When you borrow money, the lender will want to see proof that you are able to repay a loan. The lender will examine your credit history, collateral (items you own that can be sold to pay off the loan), and prospects for business success. The financial documents you include in your business plan will help show that you will be able to pay off your loan.

The five important financial documents in a business plan are the personal financial statement, the start-up cost estimate, the income statement, the balance sheet, and the cash flow statement. In this section, you will learn about the first two.

**The Personal Financial Statement**

The personal financial statement is a summary of your current personal financial condition—a snapshot of your finances. It is an important part of any loan application for a new business. It measures your financial progress to date and shows how well you have met your personal financial obligations. It compares your assets and liabilities at a particular point in time. An asset is anything of monetary value that you own, such as cash, checking and savings accounts. There are three types of checking accounts: regular, activity, and interest-earning accounts. Assets also include real estate stocks. A liability is a debt that you owe to others, such as credit card debt, school loans, car payments, or taxes.

**Assets**

To develop a personal financial statement, you first list your assets. Be realistic about the current value of your assets. For example, if you have a car worth $11,700, do not round it up to $12,000. Be sure to list all your cash assets (checking and savings accounts), any investments (stocks, bonds, mutual funds, and retirement funds), and personal assets (furniture, cars, clothes, and home). Estimate

---

**THE LENDER’S POINT of VIEW**

This ad is for a national legal firm that handles high-level financial transactions. It facilitates deals and advises lenders and borrowers.

**BINGHAM MCCUTCHEON**


**Online Activity**

**E-Dictionary**

Tell students that in order to demystify business jargon, it is important to rely on a business and finance dictionary. Ask students to find a reputable and free online business dictionary. If they come across a term or concept for which they want greater clarification, they can write it down in their journal and consult the e-dictionary.

**Virtual Business**

Introduce financing to students using Knowledge Matters’ Virtual Business Retailing visual simulation, Financing. In this simulation, students evaluate different financing methods to finance their start-up businesses.
Develop Concepts

**Assets and Debts** Ask students to generate a list of assets and debts people who want to start a business might typically have.

**Explain** Tell students that financial health is as responsible and important as a person’s health. Knowing your financial situation allows you to set financial goals, which might include starting a business, owning a car or house, attending college, saving for retirement, and so on.

**Summarize** Expand the discussion of assets and liabilities (debts). Give students examples of liquid assets and various liabilities (debts). Explain that these are specific types of assets and liabilities (debts).

### Practice 1 Answers

1. Total assets are $25,200
   $(15,000 + 5,000 + 1,000 + 1,700 + 2,500 = 25,200)

2. Total Liabilities are $16,500
   $(10,000 + 5,000 + 1,500 = 16,500)$

3. Net worth is $8,700
   $(25,200 - 16,500 = 8,700)$

**Reading Strategy**

**Estimating Start-Up Costs** Tell students that they are business consultants and entrepreneurs come to them with questions regarding starting a business. Ask them to generate a list of questions new business owners might bring to their attention.

### Borrowing From Parents

Serena, Frank, and Dominick are three friends who are going into business together. They plan to open a small sunglasses shop in a large mall. They have a clear business plan and are certain the shop will be a success if they can get the financing they need. In preparation for meeting with a bank loan officer, each of them has prepared a personal financial statement. Being young, they do not have a lot of assets, and they are concerned the bank will not consider them good risks for a loan.

**Inflating Assets**

Dominick asked his parents if they would add his name to the title of their house, just until the start-up financing comes in. They agreed, so Dominick has listed the family home as an asset. That has increased his net worth by $200,000. He feels the bank will look more favorably on the loan application as a result.

**Debts**

Next, list your debts, including your charge accounts, mortgage balance, and school and automobile loans. Calculate a total for each type of debt and a grand total for all of your debts.

**Net Worth**

Next, calculate your personal net worth. Your net worth is the difference between your assets and your liabilities. To find a business’s net worth, subtract its debts from its assets. For corporations, net worth is called stockholders’ equity; for partnerships and sole proprietorships, it is called owner’s equity.

Your personal financial statement is one way to determine whether you and your business are good credit risks. A lender will require a copy of your personal tax returns to see how you have earned money in the past. A lender will also request a credit report to determine how well you have paid past debts. If you plan to continue working at another job, the lender will be interested in whether that income can cover your personal expenses until your new business becomes profitable.

**Practice 1**

1. You have assets of $15,000 (car), $5,000 (savings), $1,000 (cash value of life insurance), $1,700 (cash), and personal property worth $2,500. What are your total assets?
2. You have liabilities of $10,000 (car loan), $5,000 (student loan), and $1,500 (credit card balances). What are your total liabilities?
3. What is your net worth?

**Note:** Answers to all the practice sets are at the Marketing Essentials OLC through glencoe.com.

**Estimating Start-Up Costs**

Before starting your business, you will need to know how much beginning your business will cost. Start-up costs are projections of how much money you will need for your first year of operation (see Figure 36.1). You also need an estimate of the long-term operating costs that you anticipate after the first year.

By assessing start-up costs before getting involved in a project, you are protecting
### Start-Up Cost Worksheet

**Fig. 36.1**

**Discussion** After students have reviewed Fig. 36.1, discuss how students would find the various figures needed to complete the worksheet. Ask them to give specific examples for particular items.

**Caption Answer** This worksheet will help an entrepreneur predict the one-time start-up costs as well as the ongoing costs of a new business.

**Online Action!** Go to the Marketing Essentials OLC through glencoe.com to find a project on start-up costs.

**Follow Up** Have students research, using one of the resources given in the text, to determine the start-up costs for a selected business. Then have them use those numbers to create this worksheet.

---

### Estimating Costs

The SBA provides many forms and worksheets to help new business owners project monthly expenses.

**Why is a start-up worksheet helpful to a new entrepreneur?**

- **Discussion**
  - Ask students to explain why a start-up worksheet helps a new entrepreneur. They might mention budgeting, planning, and decision-making. You might also discuss how this can help students manage their finances over the life of the business.

### Start-Up Cost Worksheet

<table>
<thead>
<tr>
<th>Item</th>
<th>Your estimate of how much cash you need to start your business (See column 3)</th>
<th>What to put in column 2. (These figures are typical for one kind of business.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salary of owner</td>
<td>$</td>
<td>2 times column 1</td>
</tr>
<tr>
<td>All other salaries and wages</td>
<td>$</td>
<td>3 times column 1</td>
</tr>
<tr>
<td>Rent</td>
<td>$</td>
<td>3 times column 1</td>
</tr>
<tr>
<td>Advertising</td>
<td>$</td>
<td>3 times column 1</td>
</tr>
<tr>
<td>Delivery expenses</td>
<td>$</td>
<td>3 times column 1</td>
</tr>
<tr>
<td>Supplies</td>
<td>$</td>
<td>3 times column 1</td>
</tr>
<tr>
<td>Telephone and Internet</td>
<td>$</td>
<td>3 times column 1</td>
</tr>
<tr>
<td>Other utilities</td>
<td>$</td>
<td>3 times column 1</td>
</tr>
<tr>
<td>Insurance</td>
<td>Payment required by insurance company</td>
<td>3 times column 1</td>
</tr>
<tr>
<td>Taxes, including Social Security</td>
<td>$</td>
<td>4 times column 1</td>
</tr>
<tr>
<td>Interest</td>
<td>$</td>
<td>3 times column 1</td>
</tr>
<tr>
<td>Maintenance</td>
<td>$</td>
<td>3 times column 1</td>
</tr>
<tr>
<td>Legal and other professional fees</td>
<td>$</td>
<td>3 times column 1</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>$</td>
<td>3 times column 1</td>
</tr>
</tbody>
</table>

**STARTING COSTS YOU ONLY HAVE TO PAY ONCE**

- Leave column 2 blank
- Make a separate list and enter total (See column 3)

**TOTAL ESTIMATED CASH YOU NEED TO START** $ __________ $ __________

---

### Skill Practice

**Independent Practice**

**L1** Give students the following scenario:
You estimate that your business start-up costs will be $10,200. You have $8,400.

1. What percentage of the total amount do you have? $8,400 ≈ 82%
2. What percentage of the total amount do you need? $10,200 − $8,400 = $1,800; 18%; $1,800 ÷ $10,200 = 0.1766 or 0.18; or 1.00 − 0.82 = 0.18 = 18%

**L2** Give students the following scenario:
You estimate that your business start-up costs will be $10,200. You have $8,400.

1. What percentage of the total amount do you have? $8,400 ÷ $10,200 = 0.82 = 82%
2. What percentage of the total amount do you need? $10,200 − $8,400 = $1,800; 18%; $1,800 ÷ $10,200 = 0.1766 or 0.18; or 1.00 − 0.82 = 0.18 = 18%

3. Subtract the decimal numbers you calculated for a and b. What is your answer? 0.82 − 0.18 = 0.64
4. Multiply the decimal numbers you calculated for a and b. What is your answer? 0.82 × 0.18 = 0.1476
5. Divide your answer for a by your answer for b. Round your answer to the hundredth. 4.56; 0.82 ÷ 0.18 = 4.55555 or 4.56

**L3** Give students the following scenario:
You will need about 15 percent more than the amount you originally anticipated for your business start-up costs, which was $10,200. How much money will you need altogether? $11,730; or $10,200 × 0.15 = $1,530; $10,200 + $1,530 = $11,730

**ELL** Have students translate the verbal problems into their own language first, and then into an equation.
ACCOUNTING

CONCEPTS
Ask students to list the start-up costs for a new business.
Answers may include the nature of the proposed business, the size of the business, the amount of inventory needed, the timing of cash revenues and expenses, and the time between using start-up funds from personal assets or potential lenders and the first sales of the business.

KEY TERMS
Have students review key terms, their spellings, and definitions in small groups.

RETEACH
INDEPENDENT REVIEW
L1 Assign and review Chapter 36 activities in the Student Activity Workbook.
L2 Assign and review Chapter 36 activities in the Marketing Math Workbook.
L3 Assign and review Chapter 36 activities in the BusinessWeek Reader with Case Studies.

ASSESS
AFTER YOU READ
Have students complete the Section 36.1 After You Read section review.

ONLINE STUDY TOOLS
Have students go to the Marketing Essentials OLC through glencoe.com for the Section 36.1 practice test.

ASSIGNMENTS

762 UNIT 11 — ENTREPRENEURSHIP AND FINANCE

After students have reviewed Figure 36.2, ask them to brainstorm and discuss some basic differences between primary and secondary sources.

Caption Answer A primary source of financing has the borrower using personal means to acquire funding, whereas a secondary source of financing relies on outside lenders to provide the funds for a new business.

Online Action For instructions, ideas, and answer guide, go to the Teacher Center at the Marketing Essentials OLC through glencoe.com.

Follow Up Ask students whether they would prefer to use primary or secondary sources of financing to start a new business. Have them explain their answers to the class.
department of commerce and local chamber of commerce, are valuable sources of cost information.

**Practice 2**

1. Your business has one-time costs of $25,000 and average monthly costs of $3,600. What are your total costs for the first quarter of operation? Using the same average monthly costs, what are your total costs for the year?

**Personal Costs**

Unless you are starting your new business while still working at another job, you will need money to live on during the start-up phase. Your personal costs are those expenses that are necessary for you to live. You will need to project your monthly living expenses and household cash needs for at least the first year of business. When starting a new business, you may be able to meet your personal expenses by working at another job or by relying on income from your parents or a spouse.

You may choose not to work outside your business or seek any other income, but you must plan to have enough cash on hand to pay your personal expenses. Some experts suggest you have enough start-up capital to pay for up to six months of living expenses.

Set aside the money for living expenses in a savings account or another account from which you can withdraw money without penalty. Do not use the money for any other purpose. This fund will help you get through the start-up period. The amount should cover living expenses such as regular monthly payments, household operating expenses, food expenses, personal expenses, and various tax expenses.

### Key Terms and Concepts

1. What is a personal financial statement?
2. Define asset, liability, and net worth.
3. How are one-time costs different from continuing costs?

### Academic Skills

1. Define asset, liability, and net worth.
2. Calculate the total start-up costs for an online business by using the Starting Cost Calculator on the U.S. Small Business Administration Web site and the following data:
   - Initial expenses: legal: $500; office supplies: $300; office equipment: $1,500; design: $150; brochures: $150; Web site: $500; other: $700.
   - Money needed for reserve for a total of six months: monthly payroll: $2,500; monthly rent: $750; and monthly expenses: $550.
   - Start-up inventory: $2,000.
   What are the total start-up costs for a six-month period?

### Social Studies/Economics

5. Do Internet or library research on factors considered by start-ups when locating in a particular state. Summarize research in a one-page paper.

### Concept Problem Solving:

**Start-Up Costs**

Start-up costs include several different values. When determining start-up costs, make a list of all the things that are included.

1. To solve this problem, total the amounts for initial expenses, the money needed for reserve, and the value of the start-up inventory.
2. Add each of the values together to determine the total start-up cost.

### Practice 2 Answer

1. Total costs for the first quarter are $35,800 [$25,000 + ($3,600 × 3) = $35,800].
   Total costs for the year are $68,200 [$25,000 + ($3,600 × 12) = $68,200].

### NCLB Activity correlated to Math and Social Studies Standards

**CULMINATING ACTIVITY**

Ask students to recall and provide answers to the following questions:

- Why is financial information included as part of a business plan?
  - It helps determine how the business will operate financially. Lenders want to know the business will be sound.
- Why would a bank require a borrower to insure property that the bank would hold as collateral?
  - If the property is damaged or lost, the insurance company would repay the bank.
- Have students generate a list of one-time start-up costs and the continuing costs for running a school store.
  - Possible one-time costs include renovation of existing space in the school. Continuing costs include ongoing purchase of inventory and fixtures, purchase of supplies, repairs, and so on.

Find answers at the *Marketing Essentials* OLC through glencoe.com.
Financial Aspect of a Business Plan

BEFORE YOU READ

Predict Why do you think so many new businesses fail?

OBJECTIVES
• Estimate business income and expenses
• Prepare an income statement
• Create a balance sheet
• Interpret a cash flow statement

KEY TERMS
• income statement
• gross sales
• net sales
• net income
• interest
• principal
• balance sheet
• cash flow statement

THE MAIN IDEA
Financial institutions and investors want to know how a business will use their money and how it will be repaid. The financial section of a business plan provides this information.

GRAPHIC ORGANIZER
Draw an outline that lists key financial documents.

Financial Documents
1. Prepare an income statement.
2.
3.

Go to the OLC through glencoe.com for printable graphic organizers, Academic Vocabulary definitions, and more.

Estimating Business Income and Expenses

After you estimate your start-up costs and personal living expenses, the next step is to estimate the money you expect to earn and to spend while operating your business. Many small businesses fail because they do not bring in enough revenue to pay their costs and expenses. Estimating business income and expenses is a key part of your business plan. Lenders want to see your estimates to decide whether to lend you money.

READING GUIDE

BEFORE YOU READ

Lead students to understand that new businesses fail because the timing or amounts of revenues and expenditures are different from those planned.

Develop Concepts

THE MAIN IDEA
Discuss with students the skills entrepreneurs need to convince financial institutions to lend them money.

AS YOU READ

Have students take notes on the different items needed for a new business that would require financing.
The Income Statement

The financial document used to calculate revenue, costs, and expenses is the income statement. The **income statement** is a summary of income and expenses during a specific period such as a month, a quarter, or a year. This statement is often called a profit and loss statement.

The income statement for an existing business shows the previous year’s income, costs, and expenses. The income statement for a new or planned business estimates earnings and expenses for the first few months (or the first year) of operation. **Figure 36.3** on page 766 shows a sample projected quarterly income statement. Refer to this figure as you read about the parts of the income statement.

Income statements have several major parts: total and net sales, cost of goods sold, gross profit, expenses of operating the business, net income from operations, other income or expenses, net profit before income taxes, and net profit after income taxes. Each item on the income statement is added to or subtracted from total sales to find the amount of net profit or loss.

- **Total Sales**
  - Returns and Allowances
  - Cost of Goods Sold
  - Gross Profit
  - Operating Expenses
  - Net Income from Operations
  - Other Expenses (Interest)
  - Net Profit (Loss) Before Taxes
  - Taxes
  = Net Profit (Loss) After Taxes

Now we will see how to calculate the different amounts for each part of the income statement.

**Estimating Total Sales**

The income generated by a business depends on the yearly volume of sales. Most new businesses grow slowly in the beginning, so you should be conservative in estimating your first-year sales.

Most people who start a new business have some idea about where they will sell their products. You may already have discussed your new product with potential buyers. You may even have a contract to produce a certain number of items. Suppose you are starting a new T-shirt printing business. You have a contract for 2,000 shirts, which you will sell at $8 each wholesale. Your estimated total sales will be $16,000. You would estimate your total sales at $160,000 if you think you can produce and sell ten times that amount during your first year.

It is important to calculate a reasonable estimated sales volume. You must verify your estimated sales volume by comparing it with projected industry figures for your size of business and location. Trade associations, bankers, and industry publications can help you make sales and income estimates.

The accuracy of your sales estimates will also depend on the quality of your market analysis. Losses rather than profits are common during the first year of business. In your business plan, you will need to show how you will cover any losses by investing more capital or reducing your operating expenses.

**Calculating Net Sales**

The total of all sales for any period of time is called **gross sales**. Your gross sales will simply be the total of all cash sales if your company sells only on a cash basis. When your company accepts credit and charge cards, sells gift certificates, or offers merchandise on account, then all of these different types of sales transactions must be totaled to arrive at gross sales.

Most businesses have some customer returns and allowances (credit granted to customers for damaged or defective goods kept by the customer); therefore, the gross sales figure does not reflect the actual income from sales.

**Extended Activity**

**Business Risk**

Ask students to think about why the University of Pennsylvania has a research center dedicated to risk management and the decision-making process. Have them investigate and discuss how such research might influence government and business policies.
SECTION 36.2

S Skill Practice

Independent Practice

Business Expenses

L1 Ask students to memorize the formulas for the cost of goods sold, gross profit, and net pay. They can write the formulas on flash cards and work with a partner to quiz each other.

L2 Ask students to create a spreadsheet with an income statement for a hypothetical business. They should review the differences between variable expenses and fixed expenses before starting.

L3 Ask students to locate specific IRS laws or rules regarding the time period over which someone can depreciate assets. Ask students to write a few paragraphs on why this is such a complicated issue under fixed expenses.

36.3 Projected Quarterly Income Statement

Financial Statement

An income statement summarizes a business’s income and expenses for a specific period of time. It gives a snapshot of the business’s health, showing profits or losses. This is often used to attract investors or to show lenders. Because a new business does not have a business history, it develops a projected income statement that estimates expected income and expenses for a period of time.

How might a new business gather the information needed to project income and expenses?

<table>
<thead>
<tr>
<th>Month 1</th>
<th>Month 2</th>
<th>Month 3</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>30,000</td>
<td>34,000</td>
<td>36,400</td>
</tr>
<tr>
<td>Less Returns &amp; Allowances</td>
<td>900</td>
<td>1,000</td>
<td>1,400</td>
</tr>
<tr>
<td>NET SALES</td>
<td>30,000</td>
<td>33,000</td>
<td>35,000</td>
</tr>
<tr>
<td>Cost of Goods Sold</td>
<td>19,500</td>
<td>23,000</td>
<td>22,750</td>
</tr>
<tr>
<td>GROSS PROFIT</td>
<td>10,500</td>
<td>12,000</td>
<td>12,250</td>
</tr>
</tbody>
</table>

Operating Expenses

Variable Expenses

- Advertising | 300 | 350 | 350 | 1,000
- Automobile  | 450 | 400 | 525 | 1,375
- Dues and Subscriptions | 15 | 20 | 18 | 53
- Legal and Accounting | 300 | 400 | 350 | 1,050
- Miscellaneous Expenses | 360 | 480 | 420 | 1,260
- Office Supplies | 120 | 160 | 140 | 420
- Security | 300 | 400 | 350 | 1,050
- Telephone | 90 | 120 | 105 | 315
- Utilities | 90 | 120 | 105 | 315
- Total Variable Expenses | 2,025 | 2,450 | 2,383 | 6,858

Fixed Expenses

- Depreciation | 180 | 180 | 180 | 540
- Insurance | 300 | 300 | 300 | 900
- Rent | 800 | 800 | 800 | 2,400
- Salaries and Payroll Taxes | 5,600 | 5,600 | 5,600 | 16,800
- Total Fixed Expenses | 6,880 | 6,880 | 6,880 | 20,640

TOTAL EXPENSES | 8,905 | 9,330 | 9,243 | 27,478

NET INCOME FROM OPERATIONS | 1,595 | 2,670 | 3,007 | 7,272

Other Income | 0 | 0 | 0 | 0
Other Income (Interest) | 300 | 300 | 300 | 900

NET PROFIT (LOSS) BEFORE TAXES | 1,295 | 2,370 | 2,707 | 6,372

Taxes | 325 | 590 | 680 | 1,595

NET PROFIT (LOSS) AFTER TAXES | 970 | 1,780 | 2,027 | 4,777

Net Sales is determined by subtracting returns and allowances from total sales.

Gross Profit is the difference between net sales and the cost of goods sold.

Operating Expenses are the costs of operating a business. They are divided into variable and fixed expenses.

Total Expenses is determined by adding the total variable expenses to the total fixed expenses.

Net Income From Operations is found by subtracting total expenses from gross profit.

Net Profit Before Taxes is calculated by adding other income to net income from operations, then subtracting interest expense.

Net Profit After Taxes is found by subtracting taxes from net profit before taxes. This amount represents the actual profit after income taxes are paid from operating the business for a certain period of time.

Go to the Marketing Essentials OLC through glencoe.com to find a project on personal finance.

Figure 36.3

Projected Quarterly Income Statement

Discussion

Ask students to discuss if they have ever watched or read a business broadcast or article about a public company’s projected quarterly income. Have them discuss the purpose of making this kind of information available to the public.

Caption Answer

New business owners can get this information from the Small Business Administration, the local chamber of commerce, similar businesses, or trade associations.

For instructions, ideas, and answer guide, go to the Teacher Center at the Marketing Essentials OLC through glencoe.com.

Follow Up

Have students perform research, using the sources listed above, to find the projected quarterly expenses for a business of their choice.
The total of all sales returns, discounts, and allowances is subtracted from gross sales to get net sales. The net sales figure is the amount left after gross sales have been adjusted for returns and allowances. Look at Figure 36.3 to find the net sales for each month.

**Cost of Goods Sold**

The total amount spent to produce or to purchase the goods that are sold is called the cost of goods sold. To calculate cost of goods sold, add goods purchased during the period to the beginning inventory value. Then subtract the amount of the ending inventory.

\[
\text{Beginning Inventory} + \text{Net Purchases, or Production Costs} - \text{Ending Inventory} = \text{Cost of Goods Sold}
\]

As you learned in Chapter 24, you count the stock on hand and calculate its total value to determine beginning and ending inventory amounts.

Most service businesses do not provide goods to their customers. Therefore, they do not have to determine the cost of goods sold. Their gross profit is the same as net sales. Other businesses that produce or purchase products to sell must calculate the cost of goods sold.

**Determining Gross Profit**

Gross profit or gross margin on sales is the difference between the net sales and the cost of goods sold.

The formula for calculating gross profit is:

\[
\text{Net Sales} - \text{Cost of Goods Sold} = \text{Gross Profit}
\]

Once you know the cost of goods sold, you can calculate your gross profit by subtracting the cost of goods sold from net sales.

Suppose you are employed by Downhill Racers, a company that sold $115,765 worth of mountain bikes last year. The company books show a total of $3,220 in sales returns and allowances. When you subtract the sales returns and allowances from total (gross) sales, you get net sales of $112,545. The cost of goods sold for last year totals $69,459; therefore, your gross profit is:

\[
\text{Cost of Goods Sold} = \text{Net Sales} - \text{Gross Profit} = $69,459 - $43,086 = $26,373
\]

**Projecting Business Expenses**

The next major part of the income statement is the operating expenses—the costs of operating the business, including variable and fixed expenses.

**Calculating Variable Expenses**

Variable expenses change from one month to the next. Variable costs can fluctuate depending upon the sales volume of the business. Variable expenses include items such as advertising, office supplies, telephone bills, and utilities.

Variable expenses are often calculated as a percentage of some baseline amount. Advertising expenses, for example, may average 5 percent of total sales.

**Calculating Fixed Expenses**

Fixed expenses are costs that remain the same for a period of time. These types of expenses stay fixed for months regardless of sales volume. Depreciation, insurance, rent, salaries, and payroll taxes are examples of fixed expenses.

Depreciation is a complicated fixed expense. Depreciation represents the amount by which an asset's value has fallen because of age, wear, or deterioration in a given period of time. IRS laws and rules govern the time period over which you can depreciate assets. An accountant can help you determine the asset depreciation schedule and amounts to use in listing assets on your income tax return.

Projecting other fixed expenses usually is easier because you simply add all your fixed costs, such as rent or insurance. Employee wages may be a significant part of your business expenses. Let's look at how to calculate payroll costs.

**Calculating Payroll Expenses**

To calculate payroll expenses, you must first estimate the number of employees you will have:

\[
\text{Number of Employees} = \frac{\text{Total Payroll}}{\text{Average Hourly Wage} \times \text{Number of Hours Worked}}
\]

**Extended Activity**

Explain to students that discretionary income is what is left after the fixed monthly expenses are paid. Have students discuss how a person or a business might use this discretionary income differently. Encourage students to give concrete examples.

**Virtual Business**

Introduce financial statements to students using Knowledge Matters’ Virtual Business Retailing visual simulation, *Financial Statements*. In this simulation, students learn to read and interpret financial statement information to understand the health of a business.
Develop Concepts

Calculating Variable Expenses Ask students to propose budgeting advice for someone who went from a steady paycheck to a variable one. Have students review the meaning of variable expenses and fixed expenses.

Explain Remind students that moving from a steady paycheck to a variable one requires financial discipline when it comes to saving. It’s best to have nine months of income saved in case of unemployment or minimal work cycles.

Summarize Remind students of the importance of keeping track of expenses, personally or professionally. Various software programs, such as Quicken, Microsoft Money, and Excel are built for creating and tracking budget plans, payments, and forecasts.

Extended Activity

Presenting Financials Ask students to select one company that they want to learn more about and research it using online resources, newspapers, and possibly broadcasts. Their objective is to understand the company's financial situation and hypothesize where the company is going. Ask students to create a presentation as if they are going to speak to the company's board of directors. Have them outline the company's future goals, market its current situation, and defend the findings. Students should prepare a 10-minute presentation. Encourage other students to ask the presenters questions after the presentation ends.
In estimating your total payroll expenses, you will need to use current tax rates for local, state, and federal income taxes. Remember that as the employer, you will also pay FICA and unemployment payroll taxes on your employees' earnings. You will need to include those tax amounts in your total payroll expense estimate.

Calculating Total Expenses

Once you have calculated all your operating (variable and fixed) expenses, you are ready to total your expenses. To calculate total expenses, add the variable expenses to the fixed expenses.

\[
\text{Total Expenses} = \frac{\text{Total Variable Expenses}}{} + \frac{\text{Total Fixed Expenses}}{}
\]

Net Income From Operations

After calculating your total expenses, the next step is to calculate net income from business operations. Net income is the amount left after the total expenses are subtracted from gross profit.

The formula for calculating net income from operations is:

\[
\text{Net Income From Operations} = \text{Gross Profit on Sales} - \text{Total Expenses}
\]

Suppose you own the "I Can Do That" Home Remodeling Company, which had gross profit on sales of $153,156 during the year. Your total operating expenses for the year were $88,991, so your net income from operations was:

\[
$153,156 - $88,991 = $64,165
\]

During the first years of operation, a business may have a net loss from operations. A net loss results when total expenses are larger than the gross profit on sales. The financial plan should address how the business intends to pay its debts in the short term, especially if a loss is probable during the first months of operation.

**Online Activity**

**E-Customer Loyalty**

Ask students to use the Internet to research an e-business or other company where customer loyalty has enabled a business to become a successful brand. Have students summarize their findings in a one-page response.
**SECTION 36.2**

**TEACH CONTINUED**

**Develop Concepts**

**Calculating Income and Expenses**
Divide students into four groups, each representing a type of business—manufacturing, wholesale, retail, or service. Help each group make an appointment with the owner and/or general manager of each type of business assigned. Each group should interview this person regarding how income and expenses were initially projected, and how that compares with ongoing projections. Students should write a report of their findings and present it to the class.

** Clarify** Remind students that in the business world, they might hear the acronyms, NOI (net operating income), NOPAT (net operating profit after taxes), or NOPLAT (net operating profit less adjusted taxes).

**Extend** Students may have heard “creative accounting” in the media on occasion. Company executives have been prosecuted for wiping expenses off the income statement as well as incorrectly classifying expenses as reoccurring or one-time.

**Extended Activity**
Ask students if they think a Web domain can be considered a long-term asset or a long-term liability.

**Online Activity**

**Projecting Business Expenses**
To improve their understanding of projecting business expenses, have students analyze several examples of income statements and balance sheets from existing businesses to determine the current and fixed assets and the current and long-liabilities. Students should be able to find current income statements on financial or company Web sites.
STEP 6 Total the monthly operating expenses.

STEP 7 Subtract total operating expenses from gross profit on sales to find net income from operations. Put parentheses around any projected losses; for example, a projected loss of $1,000 would be identified as ($1,000).

STEP 8 Add other income such as interest on bank deposits and subtract other expenses, such as interest expense, from net income from operations. The result is net profit (or loss) before income taxes.

STEP 9 Estimate total taxes on the net income and subtract that amount from net profit. The result is net profit (or loss) after taxes.

Creating Loyalty

Discussion Ask students to discuss what customer loyalty does for a business.

Software necessary to track customer purchasing would be listed as an operating expense on an income statement.

For instructions, ideas, and answer guide, go to the Teacher Center at the Marketing Essentials OLC through glencoe.com.

Follow Up Ask students: What other business expenses might be incurred while building customer loyalty? Answers might include: expenses for marketing efforts to reach repeat customers and build a rewards program.

PRACTICE 3 Answers

Mountain Air Bikes
Income Statement for the Year Ended December 31, 20--

Net Sales $202,736
Cost of Goods Sold $124,375
Gross Profit $ 78,361
Operating Expenses
Salaries $ 28,022
Rent $ 14,211
Utilities $ 5,214
Advertising $ 3,422
Total Operating Expenses $ 50,869
Net Income From Operations $ 27,492

Creating Loyalty

Encouraging customer loyalty has always been a goal of marketers. Marketing technology has pioneered many ways of getting customers to come back again and again. “New marketing” targets individuals rather than groups, because the software behind it collects specific information about each person.

Targeted Rewards

Harrah’s, an entertainment, resort, and casino company, asks each customer to sign up for its Total Rewards loyalty program. Customers use their rewards cards whenever they make a purchase at the resort.

Harrah’s tracks the results and offers special deals and privileges to consumers who return often even if they do not spend a lot of money on their visits.

The rewards offered are related to what the consumer has purchased in the past—free concert tickets to music lovers, for example.

The company tracked an increase of 20 percent in customer loyalty after the program’s first year.

Where would you list on an income statement the expenses for the software necessary to track customer purchasing?

Go to the Marketing Essentials OLC through glencoe.com to find an activity on technology and starting a business.
DEVELOP CONCEPTS

GUIDED PRACTICE

THE BALANCE SHEET

Give each student a copy of the balance sheet featured in this text. As a class, write a letter to a friend, describing the formula for how each of the following were achieved: assets, liabilities, and equity.

CLARIFY Tell students that some companies have found that sharing financial statements with employees can be a significant tool for motivating employee performance. To help employees who lack a financial background, the financial statement is annotated to explain the meaning of each line in the statement.

EXTEND Introduce students to the importance of the Sarbanes-Oxley Act of 2002, also known as “SarBox.” This Act was approved by Congress in response to many of the questionable ethical activities surrounding modern corporate culture. Sarbox requires companies to establish and strictly abide by their own formal documentation of internal controls. It is intended to improve corporate and individual responsibility.

READING STRATEGY

CLARIFY Introduce students to the concept of terminal value. Stockholders are aware of a company’s terminal value, meaning that one day the company will close, liquidate everything, and divide it among shareholders.

ANSWER Lenders use ratio analysis to determine how a business is performing as compared to other businesses in the industry.

EXPLAINED Why do lenders use ratio analysis?

Liquidity Ratios

Liquidity ratios are used to analyze the ability of a firm to meet its current debts. One liquidity ratio is current ratio. Its formula is current assets divided by current liabilities. In this case, it is better to have a high ratio.
The acid test, or quick ratio, is used to see if the company can meet its short-term cash needs. Its formula is cash plus marketable securities plus accounts receivables divided by current liabilities.

**Activity Ratios**

Activity ratios are used to determine how quickly assets can be turned into cash. One such ratio is called accounts receivable turnover, which indicates the number of days it takes to collect the money owed by customers. To calculate this ratio, divide net sales by average trade receivables. In this case, it is better to have a lower ratio.

The stock turnover ratio measures how many days it takes to turn over, or sell, the inventory. Excessive inventory ties up cash that a company can use to grow its business. The basic formula for this ratio is cost of goods sold divided by average inventory.

**Profitability Ratios**

Profitability ratios measure how well the company has operated during the past year. One ratio is profit margin on sales, which shows the rate of profit in percentages. This information is found on the income statement. Its formula is net income divided by net sales. Another profitability ratio is the rate of return on assets, which shows how well you are doing when compared to other companies. The formula for this ratio is cost of goods divided by average total assets.

**Cash Flow Statement**

A cash flow statement is a monthly plan that tracks when you anticipate that cash will come into the business and when you expect to pay out cash. A cash flow statement helps you determine whether you will have enough money to pay your bills on time.

Businesses need cash to pay bills and their employees, and to use for unexpected expenses. The cash flow statement itemizes how much cash you started with, what your projected cash expenditures are, and how and when you plan to receive cash. It also shows when you will need to find additional funds and when you will have cash remaining. Most lenders will require you to estimate the business’s cash flow for the first year of operation.

**Cash Payments**

When operating a business, one of your largest payments of cash will be for your merchandise. You will most likely have to pay for part of the merchandise in cash and part of it on credit.

When estimating sales for the income statement, you include both cash and credit sales. In contrast, the cash flow statement shows only the amount you expect to receive in cash (for cash sales and payments for credit sales) during the month.

### Practice 4

Using the balance sheet shown below, answer the following questions:

1. How much are the total assets for Mountain Air Bikes?
2. How much are the total liabilities?
3. What is Mountain Air’s net worth?

#### Mountain Air Bikes

**Balance Sheet December 31, 20--**

<table>
<thead>
<tr>
<th>Current Assets</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$10,000</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>$15,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>$68,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Fixed Assets</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Building</td>
<td>$120,000</td>
</tr>
<tr>
<td>Equipment</td>
<td>$80,000</td>
</tr>
<tr>
<td>Vehicles</td>
<td>$30,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total Assets</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$?</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Current Liabilities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Notes Payable</td>
<td>$3,000</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>$12,000</td>
</tr>
<tr>
<td>Salaries Payable</td>
<td>$5,000</td>
</tr>
<tr>
<td>Taxes Payable</td>
<td>$1,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Long-Term Liabilities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Notes Payable</td>
<td>$90,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total Liabilities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$?</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Net Worth</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$?</td>
</tr>
</tbody>
</table>

### PRACTICE 4 ANSWERS

#### Mountain Air Bikes

**Balance Sheet**

<table>
<thead>
<tr>
<th>Current Assets</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$10,000</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>$15,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>$68,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Fixed Assets</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Building</td>
<td>$120,000</td>
</tr>
<tr>
<td>Equipment</td>
<td>$80,000</td>
</tr>
<tr>
<td>Vehicles</td>
<td>$30,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total Assets</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$323,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Current Liabilities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Notes Payable</td>
<td>$3,000</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>$12,000</td>
</tr>
<tr>
<td>Salaries Payable</td>
<td>$5,000</td>
</tr>
<tr>
<td>Taxes Payable</td>
<td>$1,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Long-Term Liabilities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Notes Payable</td>
<td>$90,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total Liabilities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$212,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Net Worth</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$212,000</td>
</tr>
</tbody>
</table>

1. $323,000 ($10,000 + $15,000 + $68,000 + $120,000 + $80,000 + $30,000 = $323,000)
2. $111,000 ($3,000 + $12,000 + $5,000 + $1,000 + $90,000 = $111,000)
3. $212,000 ($323,000 – $111,000 = $212,000)
You may receive payment for most of your credit sales 30 days after the sales. You will also need to calculate your monthly costs for operating the business.

**How to Prepare a Cash Flow Statement**

Use the following steps to prepare a cash flow statement.

**STEP 1** Add the total cash on hand (in bank accounts) and money received from any loans to find your total start-up money.

**STEP 2** Subtract the start-up costs to determine the amount of cash left for operation.

**STEP 3** Enter the estimated cash you expect to receive from cash sales and credit sales for each month during the first year. Enter the amount of any income from business investments or additional loans.

**STEP 4** Add all sources of cash receipts to find the total cash income for the month.

**STEP 5** List the cost of goods that you will buy for your inventory. This cost should be separated into purchases for which you will pay cash and purchases on credit, which you will pay for the next month.

For example, the cash flow statement shows goods bought on credit in Month 1. This is a payment for items bought on credit prior to the opening of the business. Add the cash and credit purchases to find the total cost of inventory purchases.

**STEP 6** List the expenses you expect to pay during the month. These amounts are the same as those listed on the income statement, except for the depreciation expense.

**STEP 7** Total all expenses for the month.

**STEP 8** List amounts that will be paid out for capital expenditures. A capital expenditure is money paid for an asset used to operate the business. The purchase of a delivery truck would be a capital expenditure.

**STEP 9** List any other payments that will be made, such as repayment of the principal and interest for the loan.

**STEP 10** Add all the cash expenditures (cost of inventory purchased, expenses, capital expenditures, and other payments).

Subtract the total cash payments from the total cash received during the month to determine net cash flow. The amount of any cash payments that are higher than cash receipts should be placed in parentheses to show a loss.

**STEP 11** Add the beginning cash balance from the start-up column to the net cash flow for the month. The result is the cash surplus for the month. When the costs of operating the business are higher than income added to the beginning of the cash balance, the business will have a deficit rather than a surplus.

In that case, the business will need additional cash for its operations. The amount is listed on the Cash Needs line. The income statement does not take into account how long it may take a business to collect the cash from sales made on credit.
Loans
What can you do if your cash flow statement indicates you will need additional money during the year? You should be able to borrow money if your business has potential and your balance sheet shows enough assets to serve as collateral.

A loan can help you keep the business going during the start-up period and during slow sales months. When your cash flow projections indicate that you need to borrow money to meet monthly expenses, you will want to include monthly payments on the loan as a part of your cash needs for the rest of the year.

### Key Terms and Concepts
1. Gross profit or gross margin on sales is the difference between the net sales and the cost of goods sold. The formula for calculating gross profit is: Net Sales – Cost of Goods Sold = Gross Profit
2. Variable expenses change from one month to the next. Variable costs can fluctuate up or down depending upon the sales volume of the business. Fixed expenses are costs that remain the same for a period of time regardless of sales volume.
3. A balance sheet is a summary of a business’s assets, liabilities, and owner’s equity.

### Academic Skills
4. Net sales = $308,900 ($315,000 – $6,100); Gross profit = $96,900

---

### Practice 5
1. You have total cash of $23,000 to start your business and start-up costs of $12,000. What amount of cash is available for operating the business?
2. Suppose cash income for the first three months is $100, $750, and $980. Total expenses for these same months are $4,800, $3,400, and $2,700. What is the cash flow for each month?
3. What is the cumulative amount of cash available at the end of each month?

---

### 36.2 After You Read

**Key Terms and Concepts**

1. How is gross profit calculated on an income statement?
2. What is the difference between variable and fixed expenses on an income statement?
3. What is a balance sheet?

**Academic Skills**

4. Total first-quarter sales for the Bad Frog Beverage Company were $315,000. Goods returned by customers amounted to $6,100. The cost of goods sold to customers was $212,000. The company’s total fixed and variable expenses were $94,500. Calculate the following amounts: net sales, gross profit, net income from operations.

**English Language Arts/Writing**

5. Investigate the concept and the purpose of cash flow statements. Write a one-page paper on how a business owner could improve cash flow.

---

**CULMINATING ACTIVITY**

Ask students to recall and provide answers to the following question.

- **What steps can a company take to improve its cash flow?**
  - Answers include: Invoice promptly to customers with good credit; manage payables by making timely, accurate payments, and correct overbilling; and control overhead costs.

---

**Practice 5 Answers**

1. The amount of cash available for business operations is $11,000 ($23,000 – $12,000 = $11,000).
2. The cash flow is as follows: month 1: $4,700 ($100 – $4,800 = $4,700); month 2: $2,650 ($750 – $3,400 = $2,650); month 3: $1,720 ($980 – $2,700 = $1,720).
3. The cumulative cash available at the end of each month is as follows: month 1: $11,000; month 2: $4,700; month 3: $2,650; month 4: $1,720.

---

**NCLB Activity correlated to Mathematics and English Language Arts Standards**

- **SECTION 36.2**
- **CLOSE**
- **Number and Operations:**
  - Multi-Step Problems
- **Academic Skills:**
  - Math
  - English Language Arts/Writing
- **Mathematics and English Language Arts Standards**
- **Find answers at the Marketing Essentials OLC through glencoe.com.**
Lifelong Learning

CAREER INFORMATION
Have students go to the Marketing Essentials OLC through glencoe.com and find Chapter 36 Careers page and click on the link for the American Marketing Association’s Careers Strategies and Tips. Ask students to select one article read it, and summarize it.

FINANCING BUSINESS
To enhance their knowledge of financial information related to business, students may take business classes, including accounting, small business management, entrepreneurship, and computer classes to use financial spreadsheet software. Such classes are offered at most community colleges, by the Small Business Administration, and as regular college courses. Many companies will pay for continuing education.

Primary Source
Ask students to go to the Marketing Essentials OLC through glencoe.com and find Chapter 36 Resources. Ask them to click on the link for the American Marketing Association’s marketing dictionary and read the definitions of the finance-related terms they find.

THINKING CRITICALLY
This knowledge is crucial. Anyone in finance or accounting needs to have a thorough understanding of the principles involved in generating numbers that show a business’s financial profile.

Online Action!
For instructions, ideas, and answer guide, go to the Marketing Essentials OLC through glencoe.com.

Test-Taking Strategies
Ask students to rewrite or highlight their notes using different color ink pens a week before the test. Certain colors represent levels of knowledge—high, medium, and low. When it comes time to study, students can focus on the colors that represent their areas which need the most study.

JAMES KAISER
FINANCIAL MANAGER
AMERICAN GREETINGS CORPORATION

What do you do at work?
I gather specific financial information related to an investment (expected investment versus expected return) and develop financial performance goals, then structure the terms of the relationship in a manner that is most beneficial to American Greetings, while coaching the executive management team in developing customer-oriented strategies.

What skills are most important to you?
The most valuable technical skill important to success is in-depth knowledge and understanding of corporate finance, including profitability analysis (discounted cash flows, internal rate of return, net present value, return on net capital employed). The most valuable soft skill important to success is a broad knowledge of marketing, including product position/differentiation and product life cycle (what competitive advantages the product offers over competition, where the product is in its life cycle, and how these attributes affect product profitability).

What is your key to success?
There are two keys to be successful as a financial manager that recommends corporate profitability strategies to executive management teams. The first is financial knowledge, the ability to correctly and accurately analyze financial information. The second is presentation, the ability to market and defend your finding/results to a broad audience in a manner that achieves your objectives.
CHAPTER 36 REVIEW

FOCUS on KEY POINTS

SECTION 36.1
- Five important financial documents are the personal financial statement, the start-up cost estimate, the income statement, the balance sheet, and the cash flow statement. The personal financial statement is a summary of your current personal financial condition. Start-up costs are a projection of how much initial money you will need for your first and continuing years of operation. You also need an estimate of your personal living expenses.

SECTION 36.2
- The next step is to estimate the money you expect to earn and to spend operating your business. The financial document that is used to calculate a business’s revenue, costs, and expenses is the income statement. A balance sheet is a summary of a business’s assets, liabilities, and owner’s equity. A cash flow statement is a monthly plan that indicates when you anticipate cash coming into the business and when you expect to pay out cash. A cash flow statement shows whether you will have enough money to pay your bills.

REVIEW VOCABULARY

I. On a sheet of paper, use each of these key terms and academic vocabulary words in a written sentence.

**Key Terms**
- personal financial statement (p.759)
- asset (p.759)
- liability (p.759)
- net worth (p.760)
- start-up costs (p.760)
- income statement (p.765)

**Academic Vocabulary**
- gross sales (p.765)
- net sales (p.767)
- net income (p.769)
- interest (p.770)
- principal (p.770)
- balance sheet (p.772)
- cash flow statement (p.773)

II. What financial information should be included as part of a business plan? (36.1)

III. What factors determine start-up costs for a new business? (36.1)

IV. How do start-up costs differ from personal costs? (36.1)

V. What are the major categories that are calculated on the income statement? (36.2)

VI. How is a cash flow statement used? (36.2)

VII. What is the purpose of a balance sheet? (36.2)

VIII. What is an asset? (36.2)

IX. What does net worth tell a business owner? (36.2)

X. What kinds of financial information are presented on an income statement, a balance sheet, and a cash flow statement? (36.2)

XI. What is the formula for calculating gross profit? (36.2)

Review Facts and Ideas

2. Business plans should include a financial statement, personal living expenses, start-up costs, income statement, balance sheet, and cash flow statement.

3. The nature of proposed business, the size of business, the amount of inventory needed, the time between using start-up funds from personal assets or from potential lenders and first sales, and the timing of cash revenues and your expenses

4. Start-up costs are a projection of how much initial money you will need for your first year of operation. Personal costs are your required living expenses.

5. net sales, cost of goods sold, gross profit, operating expenses, net income from operations, and net income before and after taxes

6. A cash flow statement determines whether you will have enough money to pay your bills on time.

7. The purpose of a balance sheet is to show the amount of ownership interest and the financial strength of a business on a given date.

8. An asset is anything of value owned by a business. Current assets can be converted into cash in the upcoming year. Fixed assets are used over a period of years to operate a business.

9. Net worth is the difference between the assets of a business and its liabilities.

10. The income statement projects revenue and expenses. The balance sheet presents the assets and liabilities of the business. The cash flow statement shows how cash will flow into and out of the business.

FOCUS on KEY POINTS

See the Glossary at the back of this book for definitions of Key Terms. Academic Vocabulary definitions are on the book’s OLC.

I. A sample answers might read:

**Key Terms**
- A personal financial statement is a summary of your current personal financial condition, like a snapshot of your finances.

**Academic Vocabulary**
- A fund is a sum of money or other resources set apart for a specific purpose.

II. Net Sales
   - Cost of Goods Sold
   = Gross Profit
12. Workplace Skills
Students should encourage the friend not to ignore personal living expenses, but to complete the financial forms mentioned in the chapter to ensure adequate capitalization to be completely successful in his new enterprise.

13. Technology Applications
Students should complete a form requiring the same basic information found in the Start-Up Cost Worksheet shown in Figure 36.1 on page 761.

14. Math Practice
Develop a Budget
Suppose that you are renting an apartment and earn a yearly salary of $24,000. Develop a cost-of-living budget. Be sure to include all regular monthly payments, household operating costs, food, and personal expenses. How might you help pay for your expenses?

15. English Language Arts/Writing
Accounting
Information technology has allowed for a number of different ways to easily record a business’ finances. Go online and research several different types of software for managing business finances. Write a paragraph about each. Include in the paragraph such things as to what type of business each product is marketed, and the product’s pros and cons.

16. Business Ratios
Select an industry that interests you. Research several companies and contact the person in charge of finances at one or two companies. Interview each person to find out about three business ratios that have proven helpful to him or her in running the business. Identify each ratio and write a one-paragraph summary on why each ratio was important.

17. Investigating Start-Up Costs
Select a business and investigate its start-up costs for the financial section of a business plan. Use these resources: people in business, suppliers, trade associations, Service Corps of Retired Executives (SCORE), Small Business Administration, chambers of commerce, and start-up guides and magazines.

Activity Develop a start-up worksheet for the business and present your project in class. Include variable and fixed expenses, such as rent and maintenance contracts.

Formative Assessment
Formative assessment is an essential component of classroom work. This type of assessment provides information that is then used as feedback to modify teaching and meet student needs.

L1 Review key terms for this chapter. Ask students to write one sentence for each key term.
L2 Provide various examples of factors regarding financing a business. After each example, have the students identify the factors contained in each one.
L3 Ask students to create stories that illustrate effective ideas for business financing.

If the results of this formative assessment seem low, consider the following activity:
Ask students to create a balance sheet from scratch based on their hypothetical numbers for a business of interest.
18. Research Franchise Opportunities

Locate the International Franchise Association Web site on the Internet. Find an existing franchise opportunity to investigate. Use a word processing program to write a report describing the franchise opportunity, including the type of franchise, primary product or service, potential for growth, and other pertinent facts about it.

Role Play
Sporting Goods Store Manager

Situation Assume the role of manager of a sporting goods store who is considering starting your own sporting goods store. You are completing your business plan and investigating sources of financing for your proposed business. You are going to meet with a friend (judge) who works for a financial services business and will discuss some of the factors to consider when planning the start-up costs.

Activity You are to make note of the factors to consider when planning start-up costs for a new business. Also identify one-time costs and continuing costs. Discuss your start-up cost plans with your friend (judge).

Evaluation You will be evaluated on how well you meet the following performance indicators:
- Describe the nature of budgets.
- Explain the nature of overhead/operating costs.
- Develop company’s/department’s budget.
- Demonstrate orderly and systematic behavior.
- Make oral presentations.

For more information and DECA Prep practice, go to the Marketing Essentials OLC through glencoe.com.

MINI-QUIZ

Administer the Mini-Quiz orally. Answers are either true or false.

1. Something of monetary value that you own is called an asset. (true)
2. A debt that you owe is called a liability. (true)
3. A summary of a business’s assets, liabilities, and owner’s equity is called the balance sheet. (true)

For an expanded chapter quiz, go to Chapter 36 in the TeacherWorks™ Plus DVD and to Chapter 36 in the ExamView® Assessment Suite.
Ask the class to research at least two varieties of bicycles and their markets in a local, domestic, or international context. Examples may include BMX bicycles, mountain bikes, tandem bikes, and beach cruisers. Have students describe the different types of cycles, to whom they generally appeal, and how they are marketed. Then have students summarize the descriptions of the bicycles and their markets in a two-page report. Encourage students to add examples of advertisements or other marketing material and submit them with their reports.
Explain to students that portfolios provide evidence of their knowledge and skills in working with data, people, and concepts. Developing a portfolio can be a valuable career development and planning tool. Point out to students that verbiage should be active, brief, and grammatically correct. Encourage students to check the portfolio information available at the *Marketing Essentials* OLC through glencoe.com.

**Peer Review**

Fellow students who share common interests can serve as reviewers of the final portfolios. This review can be completed through the use of a checklist. Go to the *Marketing Essentials* OLC through glencoe.com to find a suggested checklist.

---

**Unit Review**

Now that students have completed the chapters in Unit 11, ask them to review their answers to the Analyze the Ad question on page 694. Would they answer them differently? Why or why not?

Next, ask students if they were inspired by studying this unit to pursue an entrepreneurial endeavor. Were they influenced to consider entrepreneurship as a career? What conclusions can they draw about entrepreneurship from their study of this unit? Have students organize their thoughts about entrepreneurship in a brief essay. Call on volunteers to share their writing with the class.

**STEP AHEAD**

Ask students: How do entrepreneurs improve their abilities and develop their skills?

---

**Internship Wrap-Up**

Inform students that baby boomers who take up cycling will also need information about safety gear and rules for the road. Have the class design a course that could be offered by the business, outlining its benefits, how it would be run, and a fair price to charge.

---

**Option 1 Internship Report**

Once you have completed your Marketing Internship project and presentation, include your written report and a few printouts of key slides from your oral presentation in your Marketing Portfolio.

---

**Option 2 Start Your Own Independent or Franchised Business**

Assuming you had $100,000 to start a new business, what type of business would you open? Select a business (independent or franchise) you would like to open some day and write a complete business plan for it. Assume this plan will be used to obtain additional financing. Prepare your written report using a word processing program and use presentation software for your oral presentation. See a suggested outline and key evaluation points at the *Marketing Essentials* OLC through glencoe.com.

---

**YOUR REPORT**

Use a word processing program and presentation software to prepare a double-spaced report and an oral presentation for your client. See a suggested outline and key evaluation points at the *Marketing Essentials* OLC through glencoe.com.

---

**Online Action**

Go to the *Marketing Essentials* OLC through glencoe.com to review entrepreneurship concepts that relate to DECA events.