FNQ FOOD INCUBATOR

CREATE | INNOVATE | ACCELERATE

MODULE 9

Finance & Business Fundamentals

PART 1 Learning Outcomes

On successful completion of this module you will be able to:

Prepare a Budget

Do you know the difference between gross profit and net profit? Confused about margin and mark up? Understand how to use financial ratios and calculations like these, to help manage your business. In this module you'll find how use sales calculations and ratios for profitability, liquidity, financing and turnover.

PACKAGING, INGREDIENTS & GROSS MARGIN

The cost of packaging (including labeling) and ingredients for successful microbusinesses generally ranges between 20 to 40 per cent of the product's selling price. The remainder of the sale price after the cost is paid is called the gross margin. For example, a bottle of jam priced at $9 may cost between $1.80 and $3.60 to make, leaving a gross margin that will range between 80 and 60 per cent respectively (see Table 1: A Sample Product Costing Model in Section 4.1: Manufacturing Your Product).

OPERATIONAL COSTS

These include the rent you pay on the space you use for production as well as financing, utilities and transportation costs. Section 4.1: Manufacturing Your Product provides a good example of a product costing model that you can easily follow. Remember to pay yourself and keep good records using either a software program or the services of an accountant.

Sales Calculations

BREAK-EVEN ANALYSIS

This break-even formula tells you how much you need to sell to break even. Above your break-even point your business will start making a profit. Analysing your break-even point helps you set sales goals and better manage your inventory.

Break-even point = total fixed costs/(average price of each product/service – average cost of each product/service to make or deliver).

MARGIN

A margin shows you how much of each sale is profit (as a percentage). It helps you make budgeting and pricing decisions. Lenders and investors use your margin to decide if you're a good candidate for finance.

Margin = ((sales – cost of goods sold)/sales) x 100

MARGIN VERSUS MARK UP

These are often confused, but it's important you know the difference. If you confuse mark up and margin, you could seriously undervalue your products or services. You'd risk not making enough profit to cover your costs.T

he easiest way to work out the difference is by calculating both figures. The mark up percentage is always higher than the margin.

EXAMPLE OF MARK UP VERSUS MARGIN

Mark sells a product for $15 which cost him $10 to produce. Mark wants to know what percentage of his product is profit (margin) and what percentage is mark up.

Margin = (($15 - $10)/$15) x 100 = 33%

Mark up = (($15 - $10)/$10) x 100 = 50%

So, while Mark has a mark up of 50%, his margin (profit) is only 33%.

Note: in this simplified example we use gross profit figures. This doesn't account for the overall expenses of the business.

MARK DOWN

A mark down is the percentage discount on a product. You'd generally use a markdown in a promotion or sale to:

- attract sales, or
- move extra or discontinued stock

Mark down price = original price – (original price x markdown)

EXAMPLE OF MARKDOWN PRICE

Mary wants to shift her least profitable stock. She decides to sell her goods at half price.
Mark down price = $20 - ($20 x 50%) = $10.

Profit Ratios

GROSS PROFIT MARGIN RATIO

This shows you the proportion of profit for every sales dollar before expenses. An acceptable gross profit margin ratio varies from industry to industry. In general, the higher the margin the better.

Gross profit margin = gross profit/sales : 1.0

NET PROFIT MARGIN RATIO

This shows the proportion of profit for every sales dollar after expenses. An acceptable net profit margin ratio varies from industry to industry, but generally, the higher the margin the better.

Net profit margin = net profit/sales : 1.0

EXAMPLE OF GROSS PROFIT VERSUS NET PROFIT

During May, Jeff sells 30 products at $15 each. Each product costs him $10 to produce. His overall operating costs for the month are $80. Jeff's gross and net profits for the month are as follows:

Sales = $450, cost of goods = $300

Gross profit = sales - cost of goods = $450 - $300 = $150

Net profit = gross profit - operating costs = $150 - $80 = $70

GROSS PROFIT VERSUS NET PROFIT

You can easily see the difference between your gross profit and net profit on your profit and loss statement. Your gross profit is your sales minus your cost of goods sold, but does not factor in your business operating expenses. Net profit is a better indication of profit, as it factors in your operating expenses.

RETURN ON INVESTMENT (ROI)

ROI shows how efficient your business is at generating profit from the original investment (equity) from owners or shareholders. Lenders will also use your ROI to help them determine the financial strength of your business.

ROI = net profit/owner's equity


Sabria's Healthy Kitchen
Sabria's Healthy Kitchen
CLEAN LEAN
CHOC

Operations Plan

The operations section of your business plan is where you explain – in detail – you company's objectives, goals, procedures, and timeline. An operations plan is helpful for investors, but it's also helpful for you and employees because it pushes you to think about tactics and deadlines.

Your operations plan should be able to answer the following:

- Who – The personnel or departments who are in charge of completing specific tasks.
- What – A description of what each department is responsible for.
- Where – The information on where daily operations will be taking place.
- When –The deadlines for when the tasks and goals are to be completed.
- How much – The cost amount each department needs to complete their tasks.

GOALS AND OBJECTIVES

The key to an operations plan is having a clear objective and goal everyone is focused on completing. In this section of your plan, you'll clearly state what your company's operational objective is.

Your operational objective is different than your company's overall objective. In Course One, you fleshed out what your strategic objective was. Your operational objective explains how you intend to complete your strategic objective.

In order to create an efficient operational objective, think SMART:

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- What – A description of what each department is responsible for.
- Where – The information on where daily operations will be taking place.
- When –The deadlines for when the tasks and goals are to be completed.
- How much – The cost amount each department needs to complete their tasks.

Different departments will have different operational objectives. However, each department objective should help the company reach the main objective. In addition, operational objectives change; the objectives aren't intended to be permanents or long term. The timeline should be scheduled with your company's long-term goals in mind.

PRODUCTION PROCESS

After you create your objectives, you have to think strategically on how you're going to meet them. In order to do this, each department (or team) needs to have all the necessary resources for the production process.

Resources you should think about include the following:

- Suppliers – do you have a supplier (or more) to help you produce your product?
- Equipment & Technology – does each department have the necessary equipment, technology and software to meet objectives? For instance, in keeping with the pizza business objective above, necessary tools might include:
  - Technology team: app developing software
  - Marketing team: software licenses for website analytical tools
  - Sales team: headsets, phone systems or virtual phone system technology
- Cost – what is the budget for each department?

In addition to the production process, you'll also need to describe in detail your operating process. This will demonstrate to investors that you know exactly how you want your business to run on a day-to-day basis.

Items to address include:

- Location – where are employees working? Will you need additional facilities?
- Work hours – will employees have a set schedule or flexible work schedule?
- Personnel – who is in charge of making sure department tasks are completed?

TIMELINE

Creating a timeline with milestones is important for your new business. It keeps everyone focused and is a good tracking method for efficiency. For instance, if milestones aren't being met, you'll know that it's time to re-evaluate your production process or consider new hires

Below are common milestones new businesses should plan for.

Production Milestones

Production milestones keep business on track. These milestones act as "checkpoints" for your overall department objectives. For instance, if you want to create a new app by the end of the year, product milestones you outline might include a beta roll out, testing, and various version releases.

Other product milestones to keep in mind:

- Design phase
- Product prototype phase
- Testing
- Product launch
- Additional product release

Market Milestones

Market milestones are important for tracking efficiency and understanding whether your operations plan is working. For instance, a possible market milestone could be reaching a certain amount of clients or customers after a new product or service is released.

A few other market milestones to consider:

- Gain a certain amount of users/clients by a certain time
- Signing partnerships
- Running a competitive analysis
- Performing a price change evaluation

In summary, your operations plan gives you the chance to show investors you know how you want your business to run. You know who you want to hire, where you want to work, and when you expect projects to be completed.