

2. Money and Tools for it's management

- Introduction to accounting
 - Profit and Loss
 - Cash flow
 - Balance Sheet
 - Budgets
- Sources of finance
- Stocks, Shares, Futures and Options

Introduction to accounting

- Why have accounts?
 - Instruments on the dashboard of the company
 - To control, you must first measure
 - Statutory duty

 - DO THE BUDGET
 - COMPARE WITH REALITY

Legal requirements;

- Keep proper books of account
- Annual audit
- Solvency

Double entry

- TERMS “Debits and Credits”
 - Debit: to receive. Income Owed to the company
 - Credit: to give. Outgoings. Owed by the company
- Ledgers and balances
- Accountancy programs e.g. Sage, Xero

Date	Description	Amount	Date	Description	Amount
	DEBIT SIDE			CREDIT SIDE	

Vertical Format

Income

Sales

Interest

TOTAL Income

Expenditure

Cost of goods

Salaries

Overheads

Marketing

TOTAL Expenditure

Profit

Accounts

Profit & Loss Account

Debit

Cost of Goods Sold (all goods for resale
minus any stock left at the time)
Expenses (all the costs including wages)
Profit (always a balancing figure)

Credit

Sales (invoices raised etc)

Balance Sheet

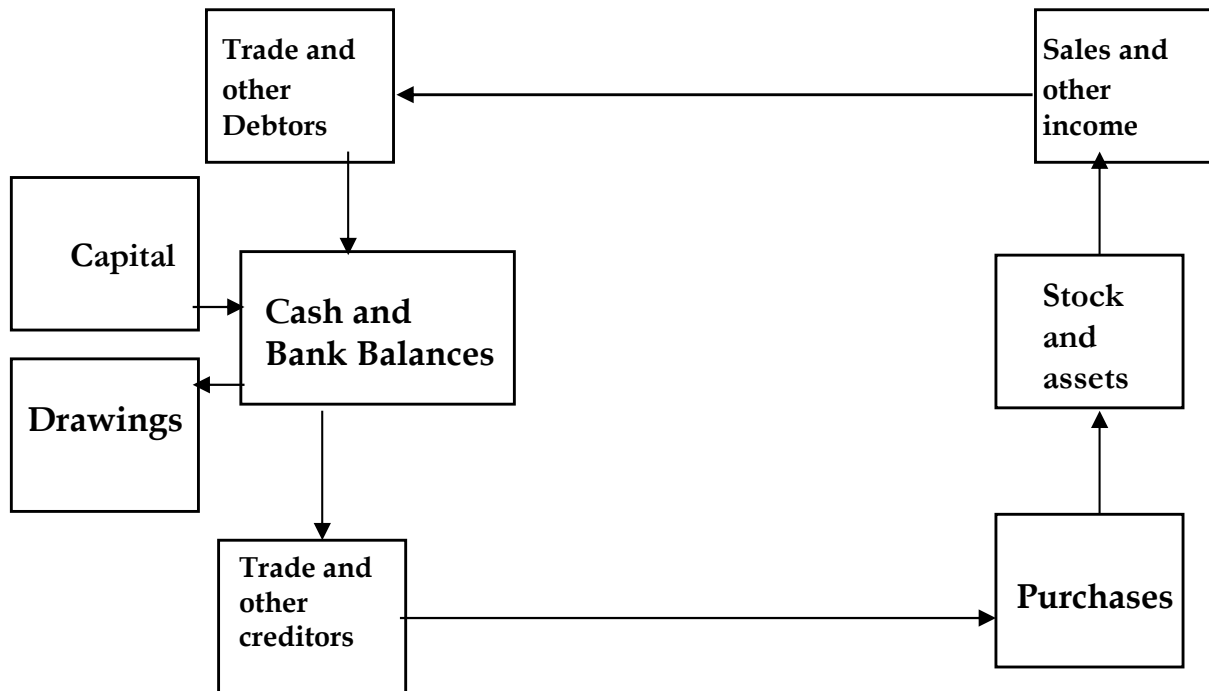
Debit

Fixed Assets (eg Computer, Car)
Debtors (people who owe you money)
Stock (goods for resale)
Bank (assuming a positive balance)

Credit

Creditors (people you owe money)
Loans (banks you owe money)
Capital (the money you put in)
Retained Profit (the profit made so far)

Interlinking of Accounts



Account Example 1

- Open a bank account with £1,000 to start your business
 - Debit: Bank £1,000
 - Credit: Capital £1,000
- Go to market and write a £600 cheque for some Mushrooms
 - Debit: Stock £600
 - Credit: Bank £600 [We could say Debit: Bank -£600 but instead we copy what real Accountants do with minus numbers and change Debit to Credit]
 - Quick check on the bank – We put £1,000 in and spent £600 leaves £400. In accounting speak Debit £1,000 then Credit £600 leaves a Debit of £400

Account Example 2

- Door to door we sell half the Mushrooms for £700 which we pay into the bank
 - Debit: Cost of Goods Sold £300 (half of £600)
 - Credit: Stock £300 (reducing stock for what we sold)
 - Debit: Bank £700
 - Credit: Sales £700

- We can then do some accounts:

– Profit & Loss Account

– Cost of Goods Sold	£300	Sales	£700
– Profit (=balance)	<u>£400</u>		<u> </u>
–	£700		£700

– Balance Sheet

– Stock	£300	Capital	£1,000
– Bank	<u>£1,100</u>	Retained Profit	<u>£400</u>
–	£1,400		£1,400

Accounts 3

- The mushrooms are looking old – We sell the remainder to a caterer for £350
 - Debit: Cost of Goods Sold £300 (being the rest of the stock)
 - Credit: Stock £300
 - Debit: Bank £350
 - Credit: Sales £350

- Now our accounts look like this:

–	Profit & Loss Account			
–	Cost of Goods Sold	£600	Sales	£1,050
–	Profit (=balance)	£450		
–	Balance Sheet			
–	Stock	£0	Capital	£1,000
–	Bank	<u>£1,450</u>	Retained Profit	<u>£450</u>
–		£1,1450		£1,450

Principles of Accounting 1

- Boundaries
 - Entity
 - Periodicity
 - Going concern
 - Quantative
- Ethics
 - Prudence - if in doubt, understate profits, overstate losses
 - Consistent - use the same rules throughout
 - Objective - avoid personal preference
 - Relevance “True and fair”

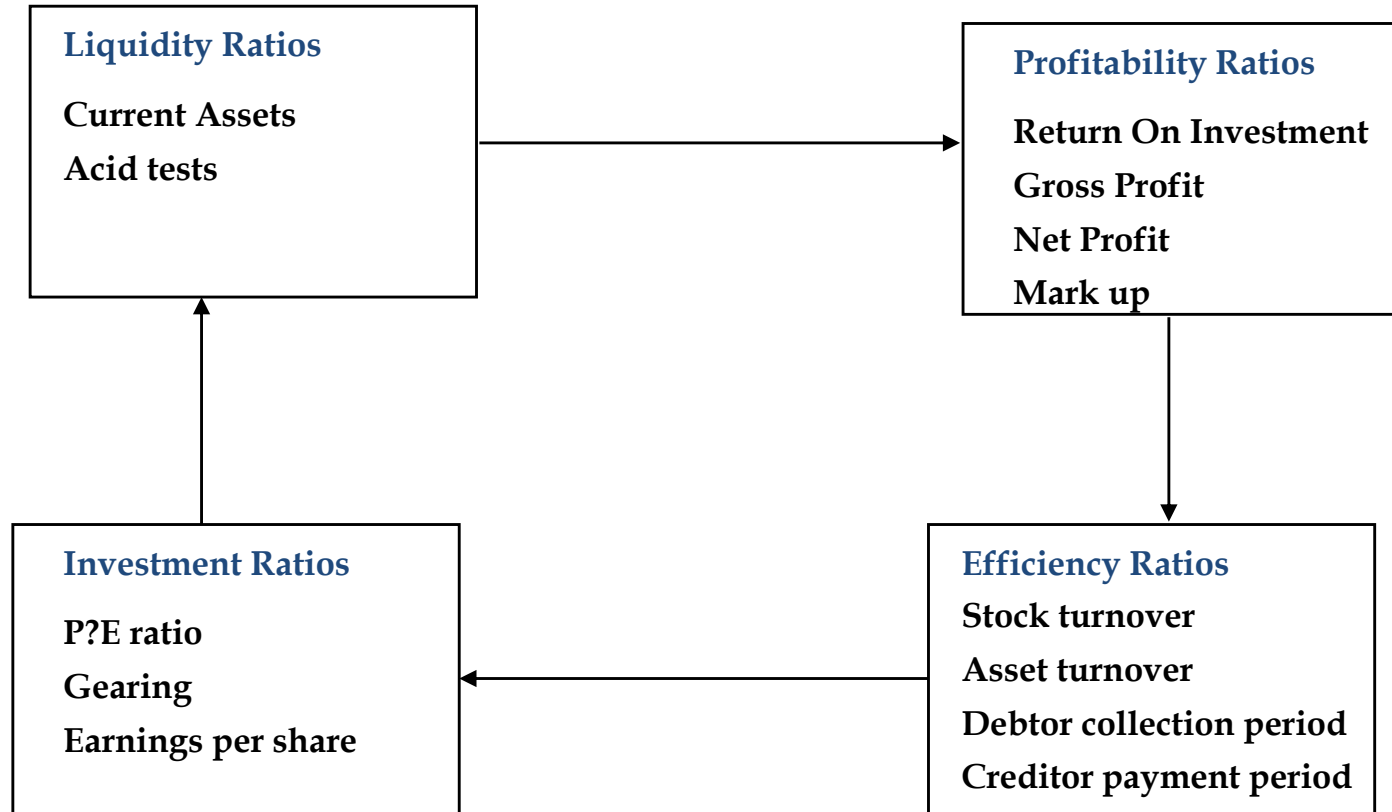
Principles 2

- Measurement
 - Money
 - Consistent cost basis
 - Realisation
 - Consistent time basis
 - Double entry
 - Materiality

Measurement of Profit

- Profit and loss account
 - Entries at invoice date
- Balance Sheet
 - Value of the company
- Cash Flow
- Vital for small companies
- Working capital statement
 - If you run out of cash you won't make the

Tests



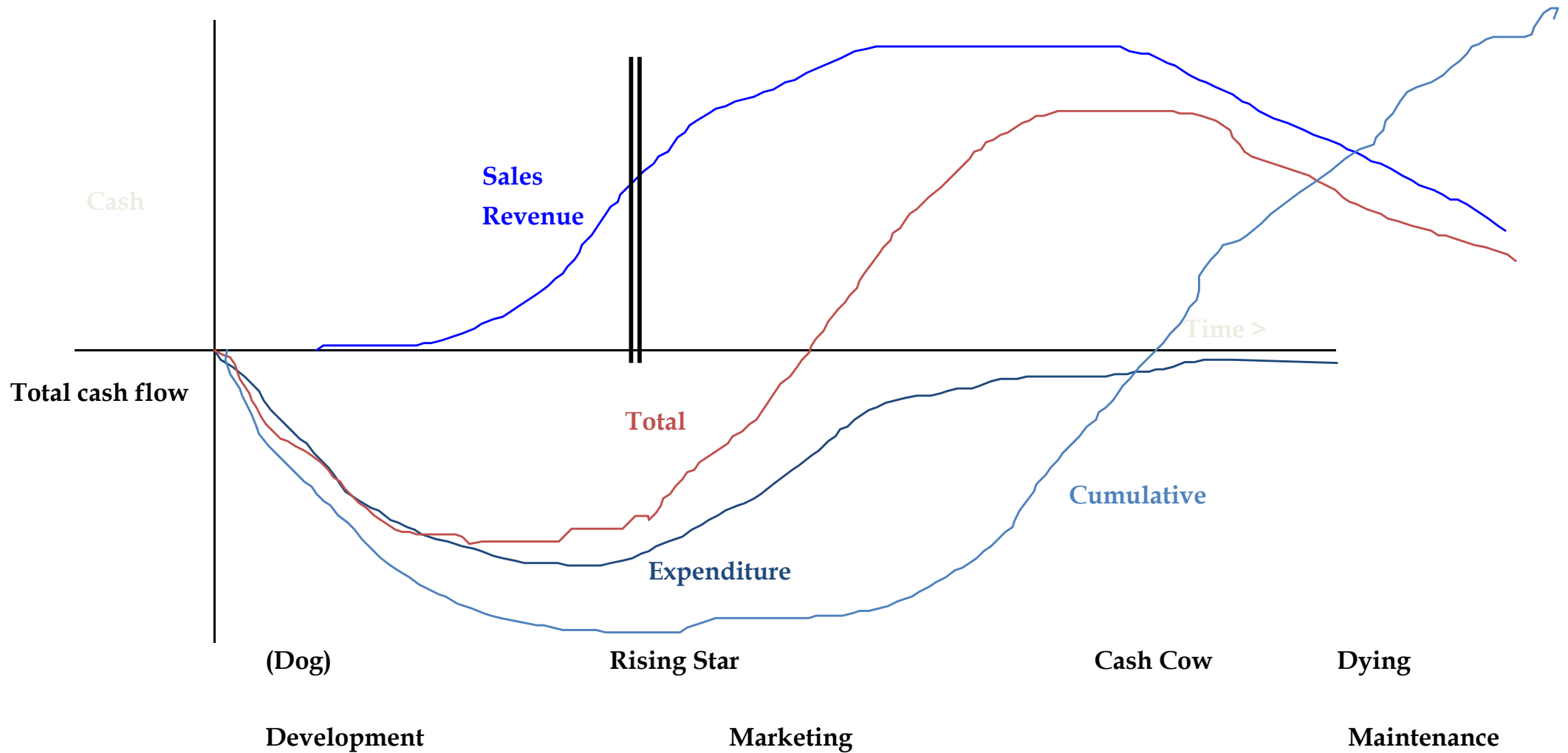
Ratios

- Current ratio
 - Current Assets / Current Liabilities
 - Measures liquidity
 - < 1 indicates potential cash flow problems
- Acid test (Quick Health check)
 - (Current Assets-Stocks) / Current liabilities
 - Stocks may not be able to be sold quickly
 - Similar to Current Ratio, but shorter term
- Gearing
 - Net Borrowings / Shareholders' Funds
 - Reliance on borrowings
 - Vulnerability to interest rate rises

Budgeting

- Assumptions
 - “Pessimistic realism”
 - Tell the truth - know the worst
- Sensitivity analysis
- Comparison with actual
- Update!!

Product stages



Debt and Equity

- Debt
 - Loan
 - Credit card, Overdraft, Mortgage, Student Loan, Debenture, Bond etc
 - Interest rates, term, conditions, collateral
 - Repay the same amount regardless performance
- Equity
 - Share of the company
 - Return depends on the performance of the company
 - Can be expensive money

How much will I need?

- DO THE BUDGET
- Working assumption no income for 1st year
 - One man band, working from home £100,000
 - 5 people, office etc £1M
 - 20 people, small factory £5M

 - Game, software package \$5M
 - New complex chip \$100M

Hard Times



Michael Beckwith, Sequoia Capital

OUR TAKE

MANAGE WHAT YOU CAN CONTROL

SPENDING

GROWTH ASSUMPTIONS

EARNINGS ASSUMPTIONS

FOCUS ON QUALITY

LOWER RISK

REDUCE DEBT

Early revenue

Low hanging fruit, Quick wins

Cash flow positive first, expansion later

Lightweight Companies

- Many computer companies need little capital to start
 - Virtual office
 - Spare time or labour for shares
 - Advanced payment from customers
 - Development clubs, Government/EU grants
- Fail early, Fail often
 - Find the market

Sources of finance

- Family and friends £50K
 - Banks
 - Security
- Angels £500K
- Venture Capitalists £5M
 - VCA
 - VCB \$25M
 - Mezzanine
- Stock Market floatation \$250M
 - Acquisition
 - Exit

FAIRY GODMOTHERS ARE NOW EXTINCT!

UK Company types

- Sole Trader
- Partnership
- Private company
- Limited Private Company (Ltd)
- Public limited company (plc)
- Listed company
- Special cases (e.g. Trusts, Societies)

Stocks and Shares

- Shares
 - Ordinary and preference
 - Voting and dividend rights
 - Critical amounts (for normal Table A companies)
 - 25+% Blocks “Substantive” resolutions
 - 50+% Day-to-day control
 - 75+% Total control
 - Other trigger points for public companies
 - Other rights and Coupons
 - Directors accountable to shareholders

Buying and Selling Shares

- Illegal to advertise unless a member of an SRO (e.g Broker),
- Private company usually requires Board approval
 - Stamp Duty 0.5%
- Public company:
 - Primary market: Floatation
 - Shares traded on a public exchange
 - Listing: admitted to the Official List (UK: LSE)
 - Secondary market
 - Settlement

Options and Futures

- Contracts to buy or sell at a fixed price at some future date
 - Typically 10%
 - Futures: Must complete as specified
 - Options: Completion optional
 - Option and future contracts can be traded
- Gambling - leave it to the professionals
 - Spread-betting www.igindex.com
- Markets are largely stochastic - no system
 - Frauds:
 - Ponzi
 - Boiler room

Fraud?

Cambs firm slated over share hike

BAD PRESS has hit Cambridgeshire varicose veins firm DioMed.

The company, which is listed on the U.S. Nasdaq exchange, has become a target for the *New York Post*.

The paper claims the company, originally a spin-out from Generics Group at Harston, is enjoying an unwarranted hike in its share price following the efforts of a stock promoter who has a large holding stashed away in the Cayman Islands.

"DioMed is exactly the sort of stock that should send any normal person fleeing the room at the mere mention of its name: suspect auditor (Andersen in the U.S.), offshore accounts, weird product, teeny-weeny revenues, board members with back stories -- this stock's got it all, the complete package," the *New York Post* says.

DioMed's share price has risen more than 200 per cent to \$7 this year, the greatest gain of any listed stock on Wall Street in this period.

CEN 27th Mar 2002

How much is it worth?

- Market value
 - What someone will pay
 - Comparisons
- Utility value
 - Customers, lock in, staff, technology
 - Cost to reproduce
- Asset Value
 - Often small for startups
 - Not what it cost
 - IPR
- NPV
 - Net present value of future profit
 - EBITDA
- DCF
 - Discounted cash flow – maybe easier to estimate
- Statistical models
 - Black – Scholes

