

**IV.**  
**Financial**  
**Management**

**Topic 39**

**Basics on Financial**  
**Management**

# FACT SHEET

## IV. Financial Management

### Topic 39: Basics on Financial Management

**Revenues or Income:** These are all monies that come into your business (for example through selling fertilizer or other products, renting property, gaining interest on money in your bank account, etc.). Grants and donations are also considered revenues.

**Expenditures or Costs:** These are all monies that go out of your business (costs you make, for example by purchasing items for resale or services, paying rent for your shop, paying interest on loans taken, etc.).

There are different types of costs:

- **Fixed costs:** These are monies spent on assets (calculator, chair, counter, etc.) and costs that occur every period, such as rent, electricity, and labor costs, irrespective of quantities of products sold.
- **Variable costs:** These are costs that vary every time you make them (for example the stock you purchase will be different every month depending on the season). These costs vary with the volume of sales.

**Profit:** This is the difference between your revenues and your expenditures. Thus, your revenues do not equal your profit.

**Investment:** This is putting money in your business to generate more revenues. This includes repainting your shop to attract more clients, putting an advertisement in the newspaper, buying a stock of products, etc. To make a large investment, such as rebuilding your store or buying large quantities of a product, you can use a loan.

**Loan:** This is money you can borrow from someone, a bank or any other financial institute. You always have to repay your loan, which means that you have to give the money back after a certain period, usually with interest. Interest is an extra amount of money on top of the loan that must be paid; it is like the costs of a loan. Your loan could be used to make an investment, so that you will have enough money to repay the loan and the interest. If you do not repay your loan, it is considered an offense, and you will probably never receive a loan again.

**Credit:** This means you purchase items or goods right away, but pay for them at a later period (for example, after one month, or on a fixed schedule every week). This can be very useful if you want to buy agro inputs before the season starts, but pay for them after the season. You can also sell goods on credit to your customers. That means that you give the goods to the customer but receive the money later. As a business you should be careful about selling items on credit, because you have expenditures to



make to keep your business running. If you do not repay your credit, it is considered an offense, and you will probably never receive credit again.

The **difference** between a loan and credit is that with a **loan** you get money to buy items and with credit you get the items right away. In both cases, you pay back the money later, often with interest.

# ADDITIONAL INFORMATION

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### Topic 39: Basics on Financial Management

#### What is financial management?

**Financial management** is the way an entrepreneur handles his/her funds. It includes bookkeeping, applying for a loan, investing in the business, etc.

**Accounting** or record keeping is a system for recording and summarizing measurements of business facts.

The relationships that exist between revenue, cost, break-even point and profit can be explained further by using simple equations:

$$\text{total costs} = \text{fixed costs} + \text{variable costs}$$

$$\text{profit} = \text{total revenues} - \text{total costs}$$

break-even point is when **total revenues = total costs** (so when the profit is 0)

The **break-even point** is the moment when the total revenues equal the total costs, which means the profit is 0. If this is the case, the entrepreneur has to either increase revenues or decrease costs, so that the profit will be positive. If a business cannot reach the break-even point, the profit will be negative and the business will lose money; action must be taken (either increase revenues or decrease costs) to correct this.

Small entrepreneurs often consider **cash inflow as their income**, and spend everything before the end of the month. However, they should use their cash inflow to invest in their business (to buy new stock, to replace old furniture, to pay salaries to staff, etc.). Small entrepreneur should set a fixed salary per month to be used for personal expenditures, such as school fees, food, clothes, etc. The rest of the cash inflow should be used to invest in the business. Therefore:

$$\text{investment} = \text{cash inflow} - \text{fixed salary}$$

At the end of each year, if there is a lot of money left for investment, the entrepreneur can give himself/herself a bonus (cash paid out of the investment money).

Every new business must have starting capital, which can consist of money that is saved and/or borrowed (for example, from friends or from a bank).

Assume that N 100,000 is raised:

1. Personal savings	= N	35,000
2. Borrowed from a friend	= N	15,000
<u>3. Short-term loan from a local bank</u>	= N	<u>50,000</u>
Total	= N	100,000

Before the entrepreneur starts the business, he/she must make some investments (for example, buy furniture, pay rent in advance, and purchase products):

Expenditures:

1. Furniture	= N	5,000
2. Rent (paid for 6 months)	= N	30,000
3. Products (the stock)	= N	60,000
<u>4. Notebooks and receipts</u>	= N	<u>3,000</u>
Total	= N	98,000

This means there is still N2,000 **in cash** (starting capital of N100,000 minus expenditures of N98,000).

Suppose that during the first month the entrepreneur sold half of the stock for a total of N35,000. This means the **revenues** are N35,000.

But there were also some costs:

1. Transport	= N	2,000
<u>2. Packaging materials</u>	= N	<u>5,000</u>
Total	= N	7,000

Therefore, the **cash inflow** is:

Revenues of N35,000 minus costs of N 7,000 = N 28,000

If the entrepreneur spends all the cash inflow, he/she cannot continue the business next month. The N28,000 must be used to buy new stock, repay part of the loan (including interest), pay the fixed salary, etc.

# INSTRUCTIONS

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#### Materials needed:

- Flip-sheet board with flip-sheets
- Markers (1 black, 1 blue, 1 green, 1 red)
- Colored cards

**Time needed:** 1 hour and 15 minutes

- Preparations:**
- Colored cards with the following text:
    - 2 cards with *revenues*
    - 2 cards with *expenditures*
  - 4 empty water bottles with a “label” that says *agro-input*
  - 12 copies of a N200 note
  - 8 copies of a N1,000 note

## Set up

- Attention:** Divide participants in four groups and give each group one “bottle” of agro inputs.
- Title:** Tell the title of the session: *Basics on financial management*.
- Credibility:** Explain your (the trainer) experience with financial management.
- Objectives:** To explain the basics of financial management (profit, credit, etc.)
- Benefits:** If you know the basics of financial management, you can organize your business and make better decisions to increase profit.
- Direction:** We are going to discuss only the basics using the bags of money. We will discuss details in later sessions.

# Delivery

## Explanation, Demonstration, Exercise and Guidance:

1. Tell each group that it is an agro-input business and that you are going to buy one bottle of agro inputs from each shop. The price of one bottle is N600. Give every group three notes of N200 and take a bottle from each table. Now, ask the groups what to call the N600 they received from you. The answer is **revenue or income**. Write the words on a flip-sheet. If someone says it is profit, ask if the others agree. Tell them that profit is the difference between revenues and expenditures. You will explain this later in detail.
2. Tell the groups that, as a business, they have to purchase items and services as well. Each group will now buy something from you. The price is N200. Let every group 'buy' the bottle that you just 'bought' from them for N200. Ask what the transaction is called. The answer is **purchase or expenditure**. Write the words on the flip-sheet under the words revenue/ income.
3. Ask the groups what the difference is between the total amount they had at the beginning (N0), and the amount they have now. The difference is N400 (N600 minus N200). Ask the groups what this is called. The answer is **profit**. Write the word on the flip-sheet under the words purchase/expenditures.
4. Start another exercise. Give two groups a card that says *revenues*, and two groups a card that says *expenditures*. Every group has to:
  - a. Try to **describe** the word (what is it)
  - b. Give at least **five examples**.
5. Let the groups work as long as they need. Then discuss the results in plenary session. Use flip-sheets to write the answers in key words. Start with the revenue groups. Ask one group for a definition. Also ask the other group for its definition. Find similar words in the definitions to write down. Continue with the examples, listing them one by one. Then discuss the results for expenditures in the same way. Possible answers are:
  - a. **Revenues** are all monies that come into your business through sales of fertilizer or other products, rent on property, interest on loans granted, grants and donations, etc.
  - b. **Expenditures** are all monies that go out of your business (costs you make), through purchase of items or services, rent for your shop, interest to be paid for loans taken, etc.

Explain that there are different types of costs:

- **Fixed costs:** These are monies spent on assets (calculator, chair, counter, etc.) and costs that occur every period, such as rent, electricity, and labor costs, irrespective of quantities of products sold.
- **Variable costs:** These are costs that vary every time you make them (for example the stock you purchase will be different every month depending on the season). These costs vary with the volume of sales.

6. Ask if anyone can describe what **profit** is. This is the difference between your revenues and your expenditures. Thus, your revenues are not equal to profit! Refer back to the demonstration at the beginning of the session. How much was the revenue? It was N600 from selling one bottle of agro inputs. How much was the profit? It was N400 (N600 from selling minus N200 from buying).
7. Continue with the **next exercise**. Collect all bottles from the groups. Tell participants that you are a bank and you are going to give them some money. Give each group N2,000 (two notes of N1,000). Tell them you want the money back in 1 month. Ask participants what the money you gave them is called. The answer is a **loan**. Ask participants what they can do with the money. They can, for example, buy agro inputs.
8. Tell participants that you are an importer of agro-inputs and that they want to buy some inputs from you. Give each group a bottle of agro-inputs and tell them they do not have to pay right away, but that they can pay you after the season. Ask the groups what this is called. The answer is **credit**.
9. Ask participants what the **difference** is between a loan and credit. With a loan, you receive money to buy items; with credit you receive the items right away. Ask what the **similarities** are. In both cases, you pay back the money later. If you do not repay the loan or credit, it is considered an **offense**, and you will probably **never** receive a loan or credit again.
10. Ask participants if a loan or credit is free. If they do not understand, ask if they should only pay back the amount borrowed or, in the case of a credit, the price of the item. The answer is no. They will have to pay a price, which is called **interest**.
11. Ask participants how a loan can be used. You can use it to buy stock, rebuild or refurbish your store, put an advertisement in the paper, paint your store, or anything that will generate more business and revenues. This is called an **investment**. An investment is spending money to generate more money. Ask if anyone has ever made an investment. Ask them to tell what type of investment and where they received the money (loan from a bank, borrowed from a friend, donation, etc.).

## Finish

**Summary:** Summarize key definitions, **revenues** are all monies that come into a business, and **expenditures** are all monies that go out (costs you make). **Profit** is the difference between revenues and expenditures. A **loan** is money borrowed, **credit** is buying or selling a product and paying or receiving the money later. The **difference between a loan and credit** is that with a loan, you receive money to buy items, but with credit you receive the items right away. In both cases, you must pay back the money later, often with interest. An **investment** is putting money in a business to generate more revenues.



**Questions:** Ask if anyone has a question or comment.

**Evaluation:** Ask participants to explain the definitions of revenues, expenditures, profit, a loan and credit, the difference between the two, and investment.

**Next step:** Now that participants understand the basics, we can begin explaining the details.

Distribute the **fact sheet** to all participants.