« where you feel you are lacking. She says: "In my case, I had absolutely no carpentry experience. My darling husband is a very talented and technically minded person and was an absolute asset when it came to executing my design ideas."

About four to five months were dedicated to research and building prototypes. For Chris, research entailed product availability, pricing, market related products, evaluating other rockers, finding material suppliers and doing a detailed costing analysis of her planned production. Finding suppliers was quite a challenge, and she says her approach was 'trial and error.' "I worked through them one at a time until I found the right person/supplier for the job. Don't you just love Google," she quips. Realising she didn't have what it took to sew the slip covers for her chairs, Chris advertised for a professional seamstress who could interpret her designs.

Hitting the ground running

Chris would have liked to spend more time on research, but found her first few customers sooner than she had expected. "It was time to test the waters – I had identified the gap in the market but had no way of determining the actual demand. I published my website with a few 'prototype' photos and within the same week I had my first three orders!" The prototype hadn't been completed, but after a few sleepless nights she was able to build the first chairs in her garage.

"Even after all my research, I still under-estimated the potential." Hoping to sell one rocker a month, within the first year Chris had sold over 200 rockers. Demand is so great that the workshop she started on her residential property is no longer sufficient. She has had to take on four full-time employees and move into a bigger warehouse. Chris has also been approached by retailers who wish to sell her chairs and is onto her third rocker design. "I can't wait to see where this business will be in the next couple of years," she concludes.

For more information visit www.sitsitso.co.za

What the expert says

THE RIGHT STUFF

Entrepreneur's Start-Up Coach, Ed Hatton, believes more entrepreneurs should follow the lead of Chris Davison.

"NO WONDER THIS is a success story. The first thing Chris did was to really look for appropriate chairs which fitted her needs, and would apply to many other new mothers. Finding none she set out to answer the technical questions – could it be built practically and at the right cost? These research steps are taken by many entrepreneurs and then they miss the next step, which is even more important. Chris did not fall into this trap. She needed to be sure that there was a viable market, that she was not simply following a dream. She had a choice of more research or test marketing, and chose test marketing. This revealed an enthusiastic market, and produced an immediate cash flow. Her only error was in underestimating demand, but this is so much easier to fix than over-estimating the potential.

HOW TO

Create financial statements... properly

Being able to create accurate balance sheets, income statements and cash flow statements could be the difference between business success and failure. By Steven Delport

Inadequate financial controls are responsible for 75% of business failures. That is, one or more of the following financial controls may be absent or inadequate:

- cash flow forecasts
- costing systems
- budgetary control
- monitoring of key performance indicators.

Why is this so? One of the reasons is that a large portion of management cannot 'talk the language of business.' Businesses exist to make a profit and to maximise returns to shareholders. So is it not essential that management at least understands what the financial statements represent and what the drivers of value are?

Let's look at the annual financial statements of a company and more specifically how the balance sheet, income statement and cash flow statement are created and intertwined. We will achieve this by building up the financial statements as part of the process of a new business starting up, and the events and requirements which unravel over time. The intention is not to cover every nuance, but rather to establish a framework and the basic principles, thus enabling the user to better grasp the annual financial statements.

Understanding your financials

- A balance sheet shows the assets and liabilities of the business at a particular date, or where the business obtains funding and what it purchases.
- The income statement shows income, expenses and profits for a particular period.
- The cash flow statement shows the amount of cash received and used by the business.

Each of the actions below is numbered and the numbers correspond to the entries in the balance sheet, income statement or cash flow statement.

Assuming we are starting a new business, we have put together the business plan and are ready to get started.

1) The first thing the business will need is money. This is typically obtained from shareholders or owners (equity) and loans (long-term and short-term, generally from banks). These are known as financing activities and result in an inflow of cash into the business.

2) The business now needs to invest in fixed (long-term) assets such as property, motor vehicles, machinery and computers. These are known as investing activities and result in an outflow of cash from the business.

3) Next we need some product to sell so we purchase stock. An increase in stock results in an outflow of cash from the business, while a decrease results in an inflow. Stock, together with debtors and creditors, make up the working capital and are short-term.

4) Assuming the above stock was purchased on credit, we now have creditors or accounts payable, that is, people or businesses to whom we owe money. An increase in creditors results in an outflow of cash from the business, while a decrease results in an inflow.

5) We sell some stock and generate revenue, also known as sales or turnover. Revenue is units sold x selling price.

6) The difference between the selling and the purchase price of units sold is gross profit.

7) As the sales were on credit, we now have debtors or accounts receivable, that is, people or businesses who owe us money. An increase in debtors results in an outflow of cash, while a decrease results in an inflow.

8) The business has various other expenses for administration, selling and marketing, which are deducted from the gross profit. The profit remaining is called earnings before interest, tax, depreciation and amortisation (EBITDA). Simplistically, EBITDA will be used in the cash flow statement as the proxy for the cash flow from operations.

9) When we purchased the various fixed assets (point 2) only the balance sheet and cash flow statement were affected. However, we are allowed to deduct an annual expense called depreciation, which further reduces profitability. Depreciation is calculated by taking the purchase price and dividing it by the number of years of its useful life. For example, depreciation for machinery purchased for R100 with a useful life of five years will be R20 per annum charge. Amortisation would apply in the same way and refers to patents and goodwill. Depreciation and amortisation are both non-cash flow items, that is, they are book entries and do not affect the cash balance, only profitability.

10) Lenders are paid interest on their loans next and we have earnings before interest and tax (EBIT), also known as operating income.

11) Taxes are deducted next resulting in net profit after tax (NPAT), or net income.

12) If the company decides to reward shareholders for their investment and the risks taken, they are paid dividends. There is no obligation to pay dividends. What is left of the profits after dividends are paid is called retained income and is retained in the business to help fund future growth, replacement or new assets, such as machinery and motor vehicles. ☐

STEVEN DELPORT is a business improvement specialist. He is the founder of Integer Consulting Solutions, which helps businesses improve profitability and cash flow.

BALANCE SHEET			
	Capital (long-term)		**Fixed assets** (long-term)
1)	Equity	2)	Property
11)	Retained income	2)	Motor vehicles
1)	Long-term loans	2)	Machinery
	Current liabilities (short-term)		**Current assets** (short-term)
4)	Creditors/accounts payable	3)	Stock
1)	Overdraft	6)	Debtors/accounts receivable

INCOME STATEMENT	
5)	Revenue
3)	**Cost of sales** (essentially the cost of stock purchases)
	Gross profit
7)	**Various expenses** (administration, marketing, selling etc)
	Earnings before interest, tax, depreciation and amortisation (EBITDA)
8)	**Depreciation and amortisation**
	Earnings before interest and tax (EBIT) or operating Income
9)	**Interest**
	Net profit before tax (NPBT)
10)	**Tax**
	Net profit after tax (NPAT) or net income
11)	**Dividends**
	Retained income

CASH FLOW STATEMENT			
	Financing activities	Inflow	Outflow
1)	Equity (raising is an inflow, repayment an outflow)	Raise	Repay
1)	Long-term loans (raising is an inflow, repayment an outflow)	Raise	Repay
	Investing activities		
2)	Purchase of motor vehicles	Sell	Purchase
2)	Purchase of machinery	Sell	Purchase
	Working capital		
3)	Stock	Reduce	Increase
4)	Creditors/accounts payable	Increase	Reduce
6)	Debtors/accounts receivable	Reduce	Increase
7)	Cash flow from operations (used EBITDA as proxy)	If a profit	If a loss

*The numbering of the items above ties in with the numbering in the article.