Co-funded by the
Erasmus+ Programme
of the European Union

Management Accounting for aspiring entrepreneurs

Project №: 2018-1-BG01-KA202-047867
“ECVET based further VET training to support the enhancement of entrepreneurship skills of young people and micro-SMEs via management accounting”

Glossary of key words

CEO	A chief executive officer (CEO) is the highest-ranking executive in a company, whose primary responsibilities include making major corporate decisions, and managing the overall operations and resources of a company. The CEO also acts as the main point of communication between the board of directors (the board) and corporate operations and is the public face of the company. A CEO is elected by the board and its shareholders.
Current Assets	These assets are cash, marketable securities, and accounts receivable. These assets are known as “quick” assets since they can quickly be converted into cash.
Current liabilities	Current liabilities are a company's short-term financial obligations that are due within one year or within a normal operating cycle. Examples of current liabilities include accounts payable, short-term debt, dividends, and notes payable as well as income taxes owed.
ECVET	The European credit system for vocational education and training
FIFO	First In, First Out (FIFO) is an accounting method in which assets purchased or acquired first are disposed of first. This is opposed to the Last-In, First-Out (LIFO) method which assumes that the last unit to arrive in inventory or more recent is sold first.
Inventory	Inventory is the term for the goods available for sale and raw materials used to produce goods available for sale.
PEST(LE)	A PESTLE analysis is a framework to analyse the key factors (Political, Economic, Sociological, Technological, Legal and Environmental) influencing an organisation from the outside. It offers people professionals insight into the external factors impacting their organisation.

Prepaid expenses	Prepaid expenses are costs that have been paid but are not yet used up or have not yet expired
R&D	Research and development
Shareholders' equity	Shareholders' equity (or business net worth) shows how much the owners of a company have invested in the business—either by investing money in it or by retaining earnings over time. On the balance sheet, shareholders' equity is broken down into three categories: common shares, preferred shares and retained earnings.
SMEs	Small and Medium-sized Enterprises
SWOT	SWOT stands for Strengths, Weaknesses, Opportunities, and Threats. A SWOT Analysis is a technique for assessing these four aspects of your business. You can use SWOT Analysis to make the most of what you've got, to your organization's best advantage.
VAT	The Value Added Tax, or VAT, in the European Union is a general, broadly based consumption tax assessed on the value added to goods and services.
VET	Vocational education and training

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Introduction

Europeans are an entrepreneurial population. There were estimated to be approximately 25.1 million small and medium-sized enterprises (SMEs) in the European Union in 2018, with the vast majority of these enterprises micro-sized firms employing fewer than nine people. In total, our European SMEs employ over 97 million people, or approximately 70% of the entire workforce [1].

Setting up a business is a goal for many enthusiast people and aspiring entrepreneurs, willing to take the risk and realise their dream. However, bankruptcies account for some 15% of all company closures. Around 700000 SMEs are affected annually and some 2.8 million jobs are involved throughout Europe on an annual basis. In the EU, the stigma of failure is still present and society underestimates the business potential of re-starters. 47% of Europeans would be reluctant to order from a previously failed business, while the average time to complete a bankruptcy in the EU varies between 4 months and 9 years [2].

These are equally daring times. Due to the COVID-19 pandemic, over 50% of Europe’s small and medium sized companies report facing bankruptcy in the next year if revenues don’t pick up [3].

An important aspect in avoiding bankruptcies and making decision on time before the situation becomes uncontrollable is offered through management accounting. Management accounting is a reporting system that provides the information necessary for the needs of you the manager, and offers you an accounting approach for planning, controlling and making decisions in the enterprise (SME). In this handy booklet we will outline some of the main aspects of management accounting as a first stepping stone towards our online course “ECVET based further VET training to support the enhancement of entrepreneurship skills of young people and micro-SMEs via management accounting” available at https://management-accounting.eu/elearning/?lang=en.

1 What is management accounting?

1.1. Essence and role of management accounting

Management accounting is developed as an accounting system in the middle of the 20th century. Management accounting secures the information and management processes in the enterprise related to measuring the achievements, defining the problems, finding solutions and treating the problems in the best possible way.

Management accounting and financial accounting are part of the accounting system of the SME. The main similarity between them is that they create information about the activity of the enterprise. However, they differ because they are two independent information systems with different reporting subjects, different methodology and aims, and above all a different purpose.

There are two primary differences between financial and management accounting. The first difference is that management accounting is presented to a company's internal community, while financial accounting is prepared for an external audience. Even though financial accounting is of great importance to current and potential investors, management accounting is necessary for managers to make current and future financial decisions for their business. The second difference is that financial accounting is exact and must adhere to generally accepted accounting principles, while management accounting can be based off a guess or estimate since most managers do not have time to get exact numbers by the time a decision needs to be made [4].

The differences between financial and management accounting can be traced in below table [5].

Table 1: Differences between financial and management accounting

Comparison indicators	Financial accounting	Management accounting
Users of information	External to the enterprise (SME) individuals and legal entities	Mostly internal individuals and managers within the enterprise (SME)
Type of accounting system	Double-entry book-keeping	Not limited to double-entry book-keeping; can use non-accounting systems as well

Comparison indicators	Financial accounting	Management accounting
Legal requirements	International Accounting Standards	In accordance with the accounting policy of the enterprise – internal regulation; no legal requirements; the only criterion is the usefulness of the information
Reporting metrics	Applies the three types of reporting metrics with an emphasis on values	Applies the three types of reporting metrics
Subjects of research and analysis	Assets and financial state of the enterprise	Various aspects of the enterprise's activity
Frequency of preparing an Annual Financial Statement	Periodically, regularly	On demand, irregularly
Authenticity and precision	Objectivity, objective assessments, no major deviations and errors occur	Accuracy and precision in compliance with the purposes of management; objective assessments, but an element of subjectivity may appear

The information provided by management accounting serves for:

- developing managerial decisions related to the financial management of various economic enterprises; analyzing the financial consequences of the decisions that have been made;
- formulating the strategy of the enterprise regarding expenditures and providing complete financial control on the activity of the enterprise in a competitive environment;
- optimizing the whole economic activity through financial and non-financial indicators.

Management accounting has its advantages, which, if rationally used by the manager/entrepreneur, can guarantee you to set up a successful business.

Its main role can be defined as providing and interpreting information about:

- formulating a strategy of the enterprise;
- planning and control of the internal managerial activities;
- making the right managerial decisions;
- optimizing the utilization of the enterprise's resources;
- delegating responsibilities among the officers in charge.

Gathering the relevant information involves a number of activities, including: observation, measuring, registering, grouping and interpreting financial and non-financial information used for managerial purposes.

1.2. Aims and functions of management accounting

The main aim of management accounting is to provide detailed information about the amount of costs and income of the enterprise by directing the management team towards the most efficient of them.

Management accounting aims at satisfying the information needs of mostly internal users (owners of SMEs, CEOs of large enterprises, their personnel) and shall not be normatively regulated, i.e., its form and content are determined by the information needs of those in charge in relation to:

- achieving the goals set by the enterprise, including performing certain economic and social activities;
- assessing precisely the performed activities in the enterprise by checking the financial result;
- forecasting the future state and development of the enterprise, including production, prices, employment, costs, income, competition, markets, etc., in accordance with the economic state in the country and the level of inflation as of each particular moment.

As part of the accounting system of the enterprise (the other part is the aforementioned financial accounting), management accounting performs the following functions:

Figure 1: Functions of management accounting

- planning: in the process of planning, management accounting supports the plans for future development of the enterprise by providing information about the types of products which shall be manufactured and sold, on which markets and at what prices;
- controlling: management accounting serves to prepare reports on the completion of the assigned tasks by comparing the actual results to the planned ones;
- organizing: management accounting organizes the information system oriented towards internal users in compliance with the accounting system of the enterprise;
- communicating: management accounting facilitates the system of communication and reporting;
- motivating: management accounting, along with the budget results and the reports, serves to seek opportunities for additional motivation of the personnel.

In the SME, the functions of management accounting are usually analyzed by the entrepreneur/manager directly involved in the recording of financial transactions and preparing financial statements.

1.3. Principles and tasks of management accounting

As a practical activity, management accounting shall conform to the following basic principles [6]:

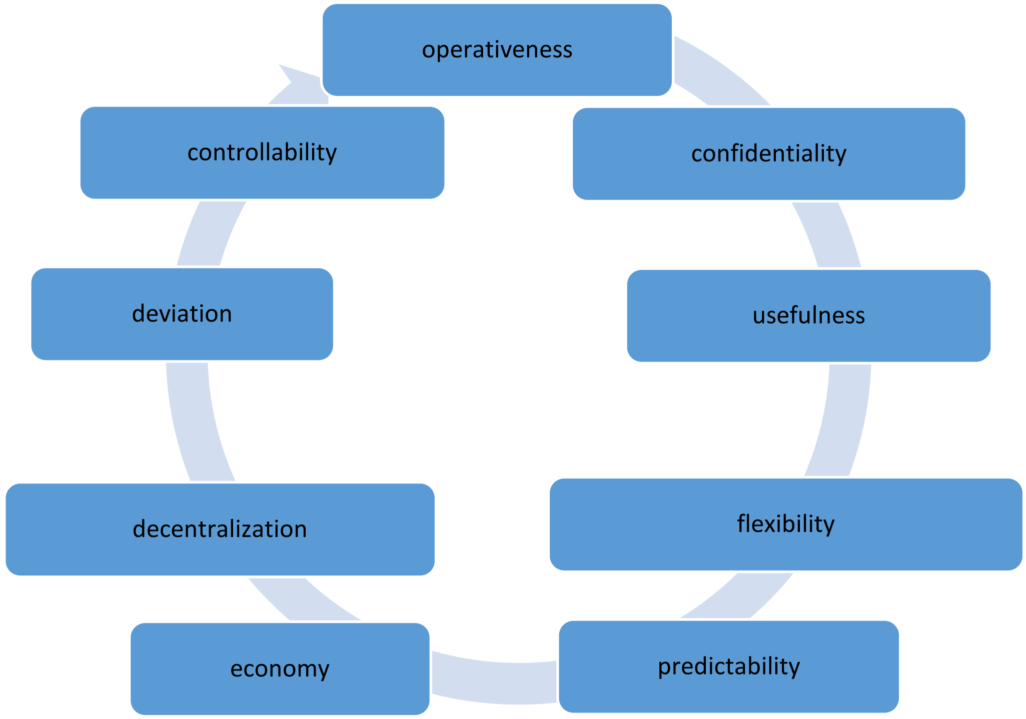

Figure 2: Principles for carrying out management accounting as a practical activity

- operativeness: it guarantees accuracy and speed of information.
- confidentiality: the information is used only for the needs of the enterprise.
- usefulness: the information is used for making certain managerial decisions.
- flexibility: management accounting adapts to the individual needs of the enterprise and the changes occurring in it.
- predictability: it provides the opportunity for reporting future costs and income for optimizing the end financial result.
- economy: it presents only information necessary for making a certain decision related to a predefined aim.
- decentralization: responsibilities are delegated to persons belonging to various hierarchical levels in the managerial organization of the enterprise.
- deviation: it reports deviations from the actual indicators against the planned ones. the relevant responsibility for them is taken, the results are analyzed, and corrective measures are taken.
- controllability: it controls the conformity to the efficiency indicators.

Bearing in mind the aims, we can formulate the following specific tasks of management accounting:

- reporting the production costs;
- calculating the production cost price;
- reporting the income and financial results;
- budgeting the costs and income;
- analysis and assessment of the economic indicators;
- taking preventive and correcting measures, including developing adequate methodology for reporting the costs and their efficiency; identifying primary and secondary activities; using new methods of analysis and assessment of the economic efficiency of the enterprise.

1.4. The information in management accounting

Management accounting is a combination of the accounting, finances and management as activities which, through the implementation of various techniques, lead to the successful management of the enterprise [7].

The information in management accounting can be divided into four categories [8]:

Table 2: Categories of information in management accounting

Category of information	Characteristics (strengths)	Characteristics (weaknesses)
Descriptive	• It is used directly for managerial purposes. • It is used to identify the manager's problems. • It shows the state of each object under management in real time. • It includes information about the scale of the financial result, the state of inventories, the production results, etc.	• It does not show the reasons and the responsible persons for the problems that may arise.

Category of information	Characteristics (strengths)	Characteristics (weaknesses)
	• It is used for preparing forecasts and for singling out alternative solutions. **The main question is:** ***What is it?***	
Diagnostic	• It describes the discrepancies between the planned and the actual state of the managerial processes – the subject of management accounting. • It identifies the existing problems. • It is used in combination with the descriptive information. **The main question is:** ***What does it have to be?***	• It is efficient only if it is detailed.
Forecasting	• It is used for decreasing the risk on the basis of problems identified through analysis. **The main question is:** ***What will it be, if …?***	• It is efficient only for a particular managerial decision and at the existence of an alternative and a possibility for counteraction.
Prescriptive	**The main question is:** ***What should it be?***	• It is efficient only when it is used in combination with the forecasting information.

The information in management accounting is intended for two types of users related to the enterprise [9]:

- internal: managers, partners, owners/entrepreneurs, personnel, etc.;
- external: creditors, controlling and tax organs, the legislation, competitors, customers, suppliers, etc.

The information is used, on the one hand, for modernizing and optimizing the production and the management of tangible assets and financial resources, while on the other hand – for innovations, human resources, social activity, solving environmental problems or initiatives, etc.

1.5. Advantages of management accounting for the SME

Management accounting shows which part of the business if profitable and how financial results develop in the long run.

Management accounting also provides the advantage for the manager/entrepreneur of the SME to know as much as possible about the performed operations (production, sales, financial result); thus he/she can make decisions based on exact figures.

Management accounting has the ability for present the SME's financial picture to bankers and potential financial investors. A clear and updated piece of information will show the entrepreneur's ability to use the capital for generating growth and the possibility to pay back the sums which have been borrowed as a loan.

2 Development of a business idea and reflection

A business idea often occurs after a situation has been observed that could be improved, or where the would-be-entrepreneur observes a potential opportunity.

The would-be-entrepreneur should assess his business idea against a number of key questions and parameters. The more NO's you have, the more chances that your business idea will need rethinking. The more Yes-answers you have, the better you are prepared to create a business plan as a next step.

Table 3: Questions the would-be-entrepreneur needs to ask when assessing his/her business idea

Questions the would-be-entrepreneur needs to ask when assessing his/her business idea	Yes	No
• Is the idea aligned with who you are?		
• Is this idea something that makes sense regarding what you like to do, what you're good at?		
• Can your business idea be realised considering your current financial status and responsibilities in life?		
• Do you have the needed skills, resources, capital and people available to realise your business idea?		
• Is the idea solving a specific need from customers?		
• Do you think people will pay for it? It is not so that you solely have to solve a need! You have to solve a need that people are willing to pay for to get solved.		
• Will your business idea be profitable? (revenues from sales will have to exceed the costs of obtaining raw materials (supplies and labour) and your added value).		
• Is it difficult for a competitor to enter your market?		
• Does your business idea allow you to be flexible if the market changes?		

Questions the would-be-entrepreneur needs to ask when assessing his/her business idea	**Yes**	**No**
• Do you have an exit strategy in mind, whereby your business should be able to function without you?		
• Is there a large enough market to make your business idea profitable?		
• Does your business idea generate recurring revenue streams? If not, you must have a solid way of attracting new customers.		
• Does your business idea require warranties that will most likely never be activated? If they are activated, you will have to provide the service!		
• Are there reasonably low barriers to entry in terms of skills, capital, legal/regulatory aspects? If there are barriers, are you able to overcome them easily?		
• Do you need considerable extra investments (more staff, machines, etc.) in case you get a lot of customers, and have you planned for this already?		
• Can you easily duplicate your business idea to other markets and territories?		

In a next step, would-be-entrepreneur should complete the following table, which contain activities, deadlines, responsible persons and financial resources for the implementation of the business idea. Having completed the previous table, you should already have thought about these activities.

Table 4: Activities, deadlines, responsible persons and financial resources for the implementation of the business idea

Activity	**Deadline**	**Responsible person**	**Funding resources and financial requirements**
• The current status of the relevant business environment			
• Typical and specific requirements for businesses running in the selected field/domain/area			
• Design of the business structure			
• Assessment phase			
• Implementation phase			
• Operation and support during implementation phase			

The next step is connected with a preparation of the business plan. The formal template on the next page shows the general layout of a standard business plan.

Table 5: General layout of a standard business plan

1. Opportunity	**Problem & Solution**	**Target Market**	**Competition**
	Problem Worth Solving Write about the problem you are solving. What do your customers need your services/goods for? Do they need a better product, a cheaper product, or just a store in a better location? Describe why customers will want to buy from you.	**Market Size & Segments** Describe your key customers. Who are they and what are their key attributes. If your company is targeting multiple customer groups ('segments'), describe each group here. If you can, include details about how many people are in each segment and how large the total market is.	**Current Alternatives** Describe your current competition. What products and services are people currently using instead of yours?
	Our Solution Provide additional detail about your product or service. What is unique and special about your company that's going to set it apart from the competition?		**Our Advantages** Explain why your product or service is better than the others. Describe any competitive advantages you may have, such as a direct access to a market, a patent or other unique component to your business.
2. Execution	**Marketing & Sales**	**Operations**	**Milestones & Metrics**
	Marketing Plan Explain how you plan people/target market(s) to know about your product. Will you use advertising? Will you attend specific fairs? Whatever your marketing plans may be, describe them here.	**Locations & Facilities** Describe your company's physical locations. This might be your office, store locations, manufacturing plants, storage facilities, etc. How much space do you have available, and how well will it meet your current and future needs?	**Milestones Table** List your key milestones and the dates that you hope to accomplish them by. If you have already accomplished key goals for your business, list them here as evidence that your business is getting positive attention from potential customers.
	Sales Plan If your company relies on sales people to close sales deals, you need a sales plan. Your sales plan should explain how you convert people who express interest in your product or service into paying customers. If you are opening a food truck, this section is less important and you can consider removing it. However, if you are starting a sales -heavy business like enterprise software or a car dealership, then you need to document how you will nurture leads and close deals.	**Technology** Describe any important software, hardware, or other information technology that you use now or plan to use later to operate your business. That might include a point-of-sale system to take payments, an e-commerce engine for your website, a CRM solution for managing your pipeline, marketing tools for generating leads, etc. **Equipment & Tools** List any specialty equipment that you have or plan to acquire to do your work.	**Key Metrics** Explain which performance metrics are most important for understanding how your business is doing. What does success mean to you, and how will you know it when you see it?
3. Company	**Overview**	**Team**	

	Will you have all the competent people in place (sales, accountancy, technical department, etc.) to allow you to operate your company and deliver goods/services?	**Management Team** Describe who will be running your company and the different divisions (if applicable).	
4. Financial Plan	**Forecast**	**Financing**	**Statements**
	Key Assumptions Describe how you came up with the values in your financial forecast. Did you project your revenue based on past results, market research, a best guess, or some other method? What kind of growth are you assuming? What are your key notable expenses? What level of profit do you expect to generate? • Revenue by month • Expenses by month • Net profit (or loss) by year	**Use of Funds** If your forecast includes loans, investments, or other financing, use this space to explain what you plan to do with that money. **Sources of Funds** Describe your financing plans. Are you investing your own money in the business? Do you have a credit card or line of credit? What other types of funds (personal or business loans, equity investments from others, etc.) do you expect to receive and when?	• Forecast of profit & loss • Forecast of balance sheet • Forecast of cash flow statement
5. Executive Summary	**Opportunity**	**Expectations**	
	• Problem summary • Solution summary • Market summary • Competition overview	• Forecast • Financial highlights by year • Financing needed	

The basic principles for the development of a good business plan are:

- Divide the business plan into sequential phases (some overlap between phases is acceptable).
- Emphasise planning, time schedules, target dates, budgets and implementation.
- Provide extensive written documentation for every phase.
- Ensure the progress of the developed business is measurable through different indicators.

In the end, the process of the development of a solid business plan helps the entrepreneur to conserve resources and plan ahead.

Below are a range of examples what can go wrong when creating business plans:

- The business plan is large, expensive, and complicated.
- The business plan doesn't have clear objectives and solutions.
- Pressure does not exist for an immediate implementation.
- The business plan requirements are defined as stable or unchanging during the system development life cycle.
- The young entrepreneurs are not fully knowledgeable with regards to the business they plan to set up.
- The young entrepreneur and his selected team members are inexperienced.
- The team structure is unstable and expected to fluctuate.
- Resources need to be conserved.
- Strict requirement exists for formal approvals at designated milestones.
- Large business plan where the requirements are not well understood or are changing for any reasons such as external changes, changing expectations, budget changes or rapidly changing technology.

Case study: Defining a good business plan may lead to avoiding a failure of a business idea, and avoiding losses. A female entrepreneur was enthusiastic to start a production of an all-organic-beauty-product set. She was motivated by the search for similar products by classmates and friends who have problems with traditional products sold in supermarkets due to allergic reactions of their skin. The idea was worked out and the bottlenecks highlighted: as she wanted the product to be fully organic and friendly to the environment, it required expensive raw materials; furthermore, organic packaging material was envisaged which were much more expensive than traditional wrapping. Bringing together all the cost elements, the envisaged final product would be quite expensive to produce and would require targeting a well off clientele, which was problematic for the Eastern European country she was based in. A short survey she conducted among friends and relatives indicated that there was a need for such products, but no willingness to pay such a high price. The business idea was dropped for now.

3 Launching in the market economy

In today's business environment, sustaining growth and profitability is never a guarantee. Technological and scientific advances shorten life cycles of products and services, business models change and new competitors appear from outside the industry. This constant instability makes it necessary to seek new business opportunities. Therefore, the young entrepreneurs must:

- Define a framework to help search for opportunities. It is therefore necessary to understand the company's business direction and to have knowledge of the resources, strengths and capabilities of the company.
- Analyse the market, assessing consumer needs and how they are being met by other companies. In order to identify market opportunities, the business model as a whole must be evaluated by identifying consumers and companies and other factors such as brand value propositions, direct and indirect competitors, supply chains, existing regulations and the general environment.

The identification of the market opportunities is based on the following 9 types of analyses.

3.1 Consumer segmentation

To understand the demand, the entrepreneur must identify consumer segments that share common characteristics. These characteristics can be "hard" variables such as age, gender, place of residence, educational level, occupation and level of income or "soft" variables such as lifestyle, attitude, values and purchasing motivations. Hard variables can help estimate the number of potential customers a business can have.

For example, a nappies/diapers producer should know how many children under 3 years live in a certain region or country as well as the birth rate. Soft variables can help identify motivations that lead to purchasing decisions including price, prestige, convenience, durability and design.

Case study: Fast Grilled Yellow Cheese is produced by a small sized enterprise in the Rhodopi Region in Bulgaria. Typical world-known halloumi cheese was perceived as delicious, but not suitable for diets due to its high fat levels. At the same time, a small survey indicated that the time needed for the preparation of a dish with typical grilled halloumi is about 8 minutes. The company realised there was an opportunity for healthy and low fat production, blending both taste and flavour, while the time to grill it could be reduced drastically. As a result, they launched Fast Grilled Yellow Cheese with a great success. The characteristics of the new products are: less salty, low fat, twice less time needed to grill it.

3.2 Purchase situation analysis

Purchase situations must also be examined to uncover expansion opportunities. Questions to ask when reviewing a purchase analysis are:

- When do people buy the offered product or service? Is it when they need it?
- Where do people make the purchase?
- How do they pay?
- Why they choose exactly this product or service among others with similar characteristics?

Looking at distribution channels, payment methods and all other circumstances that involve purchasing decisions can teach the entrepreneur how consumers buy and how the newly established company can position its product appropriately. Offering new shopping alternatives may bring new customers.

Case study: A young entrepreneur decided to develop edible coffee cups. He promotes this eco-friendly consumer attitude among coffee drinkers, as well as highlighted the improvement of the coffee taste (the after taste of plastic was now replaced with a delicious flavour). The suitable purchase situation analysis led him to following conclusions: people normally buy such kind of products every morning before going to work, so this is a fast consumed product, and paid on the spot. They purchase the product from the nearby non-stop shops, kiosks at the bus stop, etc. Using these channels, they can pay cash or by card. There are many options for these attractive cups: horoscope paper cup, quotations from famous writers' cup, joke story cup, etc. These edible coffee cups have a unique quality: you drink the coffee and then you eat the cup. The customer can finish his breakfast, with something sweet and the he/she doesn't bother him/herself where to throw the coffee cup.

3.3 Direct competition analysis

Knowing the existing players in the market where the company is competing or going to compete is important when evaluating opportunities. Relevant questions in this case are:

- What are the products and brands of the relevant industry that are growing more significantly and why?
- What is their value proposition?
- What competitive advantage will my company have over them?

Case study: A young entrepreneur, owner of a small hotel at the seaside, decided to provide a special place for camping, instead of creating a bigger car parking. This way he could provide camp facilities with a high quality, close to nature at a reasonable price. It turned out that this was the best option for young families with kids who do not want to use and pay for all-inclusive hotels, but rather prefer to pay a reasonable price for a camping place instead.

3.4 Indirect competition analysis

Opportunities can be found by analysing the substitute industries, or a business can fail because the indirect competition was not analysed thoroughly enough.

Case study: A young entrepreneur decided to rent a place for his sandwich shop, nearby a fast food outlet. He did not achieve the expected number of clients and sales, due to the fact that two services were targeted at hungry clients, who ask immediate food at a low price. Although the place was very suitable (central location) and the rent was affordable, sales were poor.

3.5 Analysis of complementary products and services

Companies should monitor the performance of other companies' products, which are complementary to their own.

Case study: A young entrepreneur with deep knowledge and skills in automotive diagnosis and repair decided to expand his initial business by adding a new service. Initially he started with offering: diagnostic analyses for cars. He monitored the sales of items, that are part of the suspension system. Therefore, he realised that it would be a perfect opportunity to start to sell brand new components of the suspension system directly to the client with a damaged car, initially diagnosed by him. This approach proved to be successful. Trends in complementary markets should be taken into account when making investment decisions.

3.6 Analysis of other industries

In some cases, the objective of companies is not to continue operating within an industrial sector but to expand a certain business model or philosophy.

Case study: A young owner of a guest's house offers an extra night for free to the clients who purchased a three days' accommodation package or more. The same business model he applied in the playground centre, managed by his wife as well as in the breath salt rooms. With this business model he managed to increase the occupancy rates in the three facilities.

3.7 Foreign markets analysis

Having information on the size of the market and competitors in other countries will help to estimate the business potential. In addition to product sales the entrepreneur can also investigate what happens in more developed countries in terms of consumption habits.

For example:

- What is the percentage of people who use the smartphone to pay for their purchases?
- What is the market share of private labels in a certain industry?

Answers to those questions in more developed countries can serve as indicators of the potential of the market in the own country. On the other hand, monitoring what happens in other countries may lead to offering of new products or services.

Case study: A young entrepreneur runs an eco-farm and a massive invasion of snails occurred. As he exported some of his goods to France, he occasionally noticed that in France there was a growing demand of extract of snails. The French cosmetic industries are popular with the production of face creams using the extract. Therefore, the young farmer seized the opportunities to expand his business plan and gained new competitive advantages, exporting also extract of snails.

3.8 Environment analysis

Market opportunities can also be identified by analysing changes in the environment, where the technological and scientific developments generate new business opportunities. Mobile technology and the Internet, artificial intelligence, robotisation, internet of things, biotechnology and renewable energy sources also provide multiple business opportunities.

Case study: A young entrepreneur with deep knowledge in software development had launched an innovative mobile application that responded to the dynamic needs of users to calculate calorie consumption, based on weight, height and intensity of physical movements. As a results of worldwide increase in smart phone usage, his app was taken up quickly and sold fast.

3.9 Regional strategies

Regional strategies can be classified into five types, each with distinct strengths and weaknesses.

3.9.1 The Home Base Strategy

Companies generally start their international expansion by serving nearby foreign markets from their home base, locating all their research and development (R&D) and manufacturing in their country of origin.

Case study: A young female entrepreneur started the production of knitted baby clothing in Plovdiv. The clothing was particularly suitable for the cold winters on the Balkan Peninsula. The regional market provided her the expected revenues and profit, as forecasted in her business plan. She decided -successfully- to expand her business to other neighbouring countries, while keeping the development and production in Bulgaria.

3.9.2 The Portfolio Strategy

This strategy involves setting up or acquiring operations outside the home region that report directly to the home base. It is usually the first strategy adopted by companies seeking to establish a presence outside the markets they can serve from home. The advantages of this approach include faster growth in non-home regions, significant home positions that generate large amounts of cash, and the opportunity to average out economic shocks and cycles across regions.

Case study: A young female rose producer generates turnover and profits by selling rose flowers in her home country Bulgaria. In addition to that she is exporting homemade rose extract in small quantities to women all over the world. She generated extra income by using her e-shop.

3.9.3 The Hub Strategy.

Companies seeking to add value at the regional level frequently begin by adopting this strategy. A hub strategy involves building regional bases, or hubs, that provide a variety of shared resources and services to local (country) operations. In its purest form, a hub strategy is simply a multiregional version of the home base strategy. The challenge in executing a hub strategy is achieving the right balance between customization and standardization.

Case study: Let’s go back to the example of the home based strategy. If the young female entrepreneur decides to expand her business to other regions, because of the demand of her products and establishes new knitting workshops in other regions/countries, then this is considered as adopting a hub strategy. It should be highlighted that the workshops within the hubs can be very independent and can function separately from each other. The more regions/countries differ in their requirements, the weaker the rationale for hubs to share resources and policies.

3.9.4 The Platform Strategy

Hubs, as we've seen, spread fixed costs across countries within a region. Interregional platforms go a step further by spreading fixed costs across regions. They tend to be particularly important for back-end activities that can deliver economies of scale and scope.

It should be noted that this strategy may not be applicable for small and medium sized companies as it requires establishing a new legal form of business as joint ventures, consortiums, holding and etc., as well as engaging of various cash deposits and investments.

3.9.5 The Mandate Strategy

Global firms in consulting, engineering, financial services, and other service industries often feature centres of excellence that are recognized as repositories of particular knowledge and skills, and are charged with making that knowledge available to the rest of the firm. Such centres are often concentrated in a single location, around an individual or a small group of people, and therefore have geographic mandates that are much broader than their geographic footprints.

IMPORTANT: It must be highlighted that both the platform a mandate strategy are the least applicable to Small and Medium Enterprises (SMEs).

4 Preparing for establishing a business

The process of preparation for establishing a business passes through the following stages:

4.1 Identification of the reasons for starting your own business

The young entrepreneur prepares himself/herself step by step passing through the following activities:

- development of right vision of what it is and what it takes to be an entrepreneur;
- completion of assessment of his/her personal traits (assessment of the strengths and weaknesses);
- improvement of the strengths and turning the weaknesses into strengths;
- evaluation of the probability for success;
- acquisition of necessary skills;
- gaining of experience.

To be a good entrepreneur means to be very well organised, managed, responsible and to be aware how to hire the right people to support.

When organising and managing the business, the entrepreneur constantly has to:

- asses his/her own performance and that of the business;
- make decisions;
- apply those decisions.

To be a successful entrepreneur, s/he has to:

- constantly look for new opportunities, and react to those opportunities;
- apply those opportunities in the most beneficial way for him/her and his/her business.

Consequently, the entrepreneur has to be skilled in:

- developing plans for his/her company;

- manufacturing, marketing, inventory supply, accounting of the company, human resource management, etc.;
- analysing facts and situations;
- making decisions;
- researching and evaluating new opportunities;
- taking advantage of the existing opportunities in the most efficient way.

In a newly established company, the young entrepreneur is the most important person. S/he will:

- define the self-motivation for establishing a company; the reasons for which s/he wants to become an entrepreneur;
- evaluating his/him personal characteristics required for the business;
- contemplation over the possibilities for imposing him/herself as an entrepreneur; perfection of the strong traits;
- defining the necessary skills for managing the company and acquiring those skills which s/he does not have;
- making an objective evaluation of his/her financial status.

Case study: While the crisis in Greece ruined many business, it also offered opportunities to others. Instead of having big companies being busy in the media sector, a whole string of small, very flexible and profitable companies emerged, sometimes with only 1 to 2 persons. These small companies did not have the large overhead costs and could offer their work (animation, advertising, etc.) at very competitive prices. Often, the founders had been working for the larger folded companies and were very well aware of the market and had already established their own commercial network of contacts.

4.2 Personal characteristics of the future entrepreneur

The personal characteristics of the future entrepreneur are:

- Devotion

- The establishment of a private business is a very important decision. It will entirely change the entrepreneur's life. The young entrepreneurs start to carry all the responsibilities for the overall management and success of the business, welfare of his/her family and the welfare of the families of the employees. This requires devotion to the business, and continuous hard efforts.

- Willingness to take risks
  - There are no business ideas, which are absolutely secure and have no risk. There is always risk in the business world. The decisions will not always bring the desired results. As a result of constant changes in the business environment, every decision might be risky and might not lead to the desired outcome. But if there is no risk, there is no profit. The efficient entrepreneurs do never risk everything. They analyse the pros and cons and make decisions based on them.
- Ability to make decisions
  - The everyday management process includes immediate decision-making. Many of the decisions might have serious consequences, but if the entrepreneur postpones them, the outcomes might be even worse.
- Initativeness
  - Nothing happens by itself. The entrepreneur success depends on the right decisions.
- The ability to adapt to the family, cultural and business needs
  - Many entrepreneurs violate their usual rhythm of life because of the conflicts among family obligations, cultural needs, and the effectiveness of the business.
- Support from his/her family
  - The management and the process of implementation of the business idea takes the entrepreneur's time and energy, which will deprive him/her from the ability to pay enough attention to him/her family. The decision to start a business has to be supported by the family.
- The ability to adapt to the needs of the customers

- The business idea will operate successfully only if it satisfies the needs of the customers.

- Self-control and the ability to cope with crisis situations
  - In case of a crisis, the entrepreneur needs to have enough self-control in order not to panic, and deal with the issues at hand in a defining manner.

Case study: A coachwork company in Belgium was active for 40 years, and was working with a small yet devoted but also reducing clientele. The founder decided to stop the business once he retired and offered his 3 kids the option to take it over. The 2 sons declined the offer, but the daughter –who was working for a French oil company- wanted to change her life and was interested to give it a try. Together with a befriended economist, she analysed the entire business, while also forecasting how much money she would need to buy out her 2 brothers. A business plan was made, whereby the expected turnover could be paid from her savings, while the envisaged expansions would require lending money from the bank. This was 6 years ago. The company went through a complete revision, whereby new clientele and additional staff was attracted, and has now an increased turnover and profit, combined with a new plant to allow further expansion, outside the original residential area.

Case study: An enthusiastic entrepreneur/developer had designed a very advanced ERP system module, totally tailored to the needs of a very specific customer. It took him 2 years to develop the desired configuration. His investments, apart from the time worked, had been minimal, and were restricted to the laptop and software he had purchased. On the day of the delivery, the company informed him that finally they had decided that they would go ahead by the end of the year with another commercial solution, and as such would no longer contract him. While he did get paid for the work performed, his only customer left him, whereas he had no back-up plan available.

As a business owner, you always must avoid depending on one customer/client alone.

A checklist for evaluating personal characteristics of a future entrepreneur can be handy. Following questions will guide the would-be-entrepreneur when evaluating the preparedness for a start-up:

Table 6: Checklist for evaluating personal characteristics of a future entrepreneur

Questions:	Response:
1. What do I want to achieve?	
2. What would be the consequences of the decision and how will it affect the business?	
3. When is the decision making necessary?	
4. What are the possible opportunities for action?	
5. What is the expected result?	
6. How would the unforeseen circumstances affect the expected result?	
7. What would be the effect of the changes in the expected circumstances?	
8. How would they affect the end result?	
9. What would be the expected losses?	
10. What safety measures should be taken into account?	
11. How would the losses affect your business?	

4.3 The required physical resources and financial capital, and the necessary starting capital

The young entrepreneur must identify the resources required to prepare for business and have the business take off effectively. The size of these resources will depend highly on the nature and complexity of the business: a manufacturing business has more needs than a consultancy business after all.

In a next step, it is important to prioritise the need for the resources. Maybe some might be nice to have at some point in the future, but are not essential for the first business year.

Following is a checklist example of the physical resources required for setting up a small textile business. It is not exhaustive, but very indicative.

Table 7: Checklist example of the physical resources required for setting up a small textile business

Resources	Already available	Essential to purchase for start-up	To buy during first year
Transport	Yes , I have my own truck available.	Yes, I need to buy a small truck lift.	Not needed
Fixtures and fittings	The rented building possesses all fixtures and fittings needed.	Not needed.	Not needed
Plant and machinery	Yes, 2 handlooms available.	Cutting edge machinery to be purchased.	All relevant machinery to be purchased during the first year.
Furniture and office equipment	Personal furniture not in use at home, will be adapted for use in the administrative office.	Office round table and chairs to be purchased.	All additional equipment needed for the normal work space.
Resale stock	N/A	N/A	N/A
Raw materials	Initially some available raw materials can be used (short term period).	Yarns, fabric, trims and accessories.	Yarns, fabric, trims and accessories to be purchased regularly.

Components	Initially some available components can be used (short term period).	To be purchased immediately.	Sewing threads, beads and sequins, ribbon, binding, cords, and braids, interfacings, pre-manufactured motifs, shoulder pads, riverts, LED bulbs, boning, elastic to be purchased regularly. Animal materials (wool, silk), plant (cotton, flax, jute), mineral (asbestos, glass fibre), and synthetic (nylon, polyester, acrylic) to be purchased regularly.
Materials	Initially some available components can be used (short term period).	To be purchased immediately.	Stationery, envelopes, postage, computer disks, and printer ribbon, tea, coffee, milk, and sugar, protective clothing, safety wear, or uniforms.
Consumables	N/A	Identified and purchased immediately with the start-up.	To be purchased regularly, after identification.

After identifying the resources, you need to allocate realistic prices or costs to each item. These will be used to feed into the budgetary plan and cash flow forecasts.

Minor items will probably be paid for at the time of purchase, but for major items of capital expenditure like machinery or vehicles, decisions must be made about how these will be financed. The need to obtain and repay loans to buy equipment, or the payment of hire-purchase deposits and the subsequent phasing of payments for buildings or vehicles, must also be accurately reflected in the budgetary plan and cash flow forecast.

Below some resources are more detailed:

- Transport
  - The selection of vehicles required will depend on the type of goods or services which are being produced and also on the distribution channels and the relative locations of the customers. Into consideration should be taken not only the costs of acquiring a vehicle, but also the running costs such as road tax, insurance, repairs and maintenance, etc. It is therefore useful to check what business vehicles are available with what maintenance costs. Can you find an affordable second hand in a good condition, or do you want immediately brand new vehicles? If you plan to do many kilometres, then a new vehicle may be the best option. This will affect your budgetary plan accordingly.
- Fixtures and fittings
  - These are essentially the items within the premises which are attach to the structure, or which are necessary to the production of the goods or services, but are not directly involved in their creation or provision (heating, AC, water taps, basins, etc.). However, they may affect temperature and humidity and are needed. These can be installed in an affordable manner if you are under budget constraints. Or some will be provided already by the owner in case you rent a place. This should be carefully checked before starting a rent.
- Machinery
  - Machinery can be very expensive, and especially if it is mobile, can be easily stolen. Thus, there are implications for their insurance and the safe and secure storage of some or all of these items, particularly if they are valuable.
- Furniture and office equipment
  - This category will include not just the items within any management or administrative office, but also the carpets, easy chairs, display material that may be located in a reception area for visiting customers; and of course the tea and coffee cups, kettle, toaster, or microwave oven for staff use.

- Resale stock
  - Anyone involved in wholesaling or retailing will need to identify what stock has to be held at any one time, or not.
- Raw materials and components
  - The initial costs of buying the raw materials and components have to be realistically estimated. The process will normally include identifying the various alternative suppliers, the range and quality of their respective products, and their costs, discount structures and terms and conditions of trade.
- Materials and consumables
  - These are the items which are purchased, used and replaced on a fairly regular basis as part of the administration or running of the business. The accounting classification is less important than the fact that they should be identified and included in the budgetary plan and cash flow forecast, because although they are all quite minor items of expenditure, when aggregated and take over a year, they can amount to a noticeable sum.
- Public utilities
  - By these we mean the suppliers of electricity, gas, telephones, water supply, sewage disposal, and waste disposal services.

Case study: A young entrepreneur started up a consultancy business and decided to use a local accountancy office to support him. As he moved into contracts with foreign companies, working also effectively abroad as in-house consultant, he ignored the fact that the local accountancy office had no expertise in dealing with undertaking work abroad. As a result of this, the business was heavily fined by the Belgian tax authorities based on wrongly completed tax declarations.

As a business owner, you have to make a crucial decision at the very start: will I do accounting in-house or will I outsource it to a competent (and most likely more expensive) accountancy office? This decision is very important as it can save you many headaches and financial fines by the tax authorities.

5 Preparing for running an own business

5.1 Developing incomes and expenditures

Your business may have one or more expected streams of income. It is however important to ensure that you are not depending only on one income stream, especially if that is related to a sole client. To be solid, you need to ensure you get multiple clients and where possible you can diversify what you will produce, whether in goods and or in services.

Important is also to understand what money goes out of your business, for example to purchase raw materials, pay salaries, etc.

Combining what comes in and what goes will give you an idea how the business is evolving financially. It is therefore handy to make a cash flow statement which lists the flows of cash into and out of the business in a past accounting period. A projection of future flows of cash is called a cash flow budget.

Working capital is an important part of your cash flow analysis, as it is the amount of money you will need to operate your business as well as conduct transactions.

working capital = current assets – current liabilities

Working capital is calculated as your current assets (cash or near cash assets), minus the current liabilities (liabilities due during the upcoming accounting period).

Doing so, you get a good idea of the liquidity of the business over the future accounting period. If the working capital is sufficient, then things are fine. However, if the working capital appears to be insufficient, then this may highlight liquidity problems for the coming year. Without adequate cash your business cannot function as you will lack the cash to pay for expenses.

The cash flow budget approach will identify any cash deficit periods in advance so you can take corrective actions now to avoid the projected deficit.

An often made mistake by young entrepreneurs is regarding the cash flow as profit. It is not! It only lists cash inflows and cash outflows while the income statement lists income and expenses.

IMPORTANT: A cash flow statement shows liquidity while an income statement shows profitability.

Case study: A young newspaper shop owner had just started and was doing fairly well. Every morning his shop was full with customers, buying newspapers, cigarettes, sweets, etc. Yet, a year later the shop owner was declared bankrupt. What had happened? The young entrepreneur had mistakenly regarded cash flow as pure profit and had it immediately spent on a new car. However, in time he increasingly was unable to pay suppliers, as the cash flow money had been used irresponsibly. Only after all incomes and expenses have been balanced can one see the profit before taxes. Also the latter is often forgotten by inexperienced entrepreneurs.

Case study: A young farmer son decided to take over the business of his father. His father had solely survived on buying and selling cattle, taking advantage of a rather abundant set of subsidies that existed for livestock. As the young son took over the business, the subsidy rules changed, thereby making buying and selling of cattle hardly profitable. The son having no other business but cattle, had to stop the farm and start working in a nearby food factory to meet ends.

5.2 Visit experienced entrepreneurs and different institutions (state, public and private) to acquire basic information about how to communicate and interfere with them

It is crucial for would-be-entrepreneurs to have a good understanding of what it takes to run a business. It is therefore recommended that these entrepreneurs visit existing entrepreneurs and learn from them in terms of how to run a business, how to establish a realistic business plan, who to get in touch with when setting up a business, the possible use of a mentor, etc. Learning from mistakes, failures, etc. are equally of interest as they will offer do’s and don’ts when starting a business.

Based on experiences from various business owners, the table on the next page offers an insight in the do’s and don’ts for young entrepreneurs.

DO's	DON'Ts
• Make mistakes: When starting your own company, you will make mistakes. However, and this sounds like a cliché, you need to learn from them. That way you will dodge it in time it ever arises again. E.g. be careful with giving credits to clients. • Take risks: As young entrepreneur, you will want to implement new strategies and innovative ideas. Some will work, some not. But the ones that do work out well will make your business flourish. • Network/meet new people: It is important to meet new people, establish your own network and learn from them and their experiences. • Welcome feedback: Feedback may be negative, but in the end it will help you to improve your business. In your pursuit for perfection, A fresh pair of eyes may open your eyes for new opportunities, or avoid disaster. • Get rid of all your debts: When starting a business, ensure you do not have other debts you need to worry about. You will have many things to worry about in your business and the last thing you need is the bank calling you for past debts, etc. • KISS – Keep it simple, stupid: No matter what you do, nothing beats simple, be it a business plan or an email communication or anything in between.	• Caring too much about what others say: Don't care if family thinks you should be working in a multinational company. Go for your dream, but based on a sound business plan! • Complacency: No successful entrepreneur ever became successful by being complacent. Instead, try new ideas and jump on opportunities. • Impatience: Nothing great was made in a day. It will take a lot of work and time, sleepless nights, etc. to achieve a successful business. But do persevere in what you want to achieve. • Hire friends or family: Hiring friends or family members may seem like a good idea initially. But if things go wrong and as owner you need to fire them, then the problems really start. • Try to do it all by yourself: Delegate and outsource whatever you cannot do yourself in the quality desired. Some examples: You have hired employees, then do delegate work to them! Your accounting is crucial, why then hiring expensive accountant when you can as well outsource it to an expert company. • Falling in love with your idea: A business in order to be profitable has to be feasible and sustainable. You may have always dreamt of opening a clothing shop, but having 20 other clothing shops in the same small town will guarantee you anything but profit.

5.3 Leadership styles [10]

All management styles originate from two sharply contrasting styles: the autocratic one and the permissive one:

- Autocratic: You make all the decisions
- Permissive: You permit your employees to take part in decision making. Moreover, employees have a considerable degree of autonomy in completing routine work activities.

Generally, there are six management styles that derive from this:

- Authoritative: The manager commands individuals and groups of people, sets high performance standards and punishes those who don't meet the performance norms.
- Directive: The manager provides the vision to the team, gives clear directions and standards. Then, the manager steps back and allows the team to work.
- Affiliative: The manager creates harmony in the workplace, avoids conflicts and creates good personal relationships.
- Participative: The manager asks the opinion of all the team members and encourages the employees' input in the decision making process.
- Pacesetting: The manager has as primary objective to accomplish tasks with a high standard of excellence, performs personally many tasks and asks the employees to follow his/her example.
- Coaching: The manager focuses on the learning experience and has as an objective the long-term professional development of the employees.

Successful managers do not always perform the same management style. They adapt their style accordingly to the task, the people who are in charge to carry it out and the company's available resources. Below we explain the characteristics of each management style and when it is effective for achieving company's goals:

- Directive: The "Do it the way I tell you" manager. S/he motivates employees with threats and punishments. This is effective when a) there is a crisis, or b) when deviations are risky.

However, this is ineffective when a) employees are underdeveloped (little learning happens with this style), or b) employees are highly skilled (they become frustrated and resentful at the micromanaging).

- Authoritative: The "firm but fair" manager. This manager will motivate employees with persuasion and feedback on their task performance. This is effective when: a) there are clear directions and standards needed, or b) when the manager is credible. This is however ineffective when a) the employees are underdeveloped (they need guidance on what to do), or b) when the manager is not credible - people do not follow the manager's vision if they don't believe in it.
- Affiliative: The "People first, task second" manager. This manager will motivate employees by trying to keep them happy. This is effective when a) it is used with other styles, b) when the tasks are routine, c) when it is combined with counselling, d) or to manage conflicts. However, this is totally ineffective when a) the performance itself is inadequate, or b) when there are crisis situations that need direction and guidance.
- Participative: The "Everyone has input" manager. This manager will motivate employees by rewarding team effort. This is effective when a) employees work together, b) staff has experience and credibility, c) there is a steady working environment. It is however ineffective when a) employees must be coordinated, b) there is a crisis and there is no time for meetings, c) there is a lack of competency (close supervision required).
- Pacesetting: The "Do it myself" manager. This manager will motivate employees by setting high standards and by expecting self-direction from them. This is effective when a) people are highly motivated, competent, b) when little direction/coordination is required, c) when managing experts. It is however ineffective when a) workload requires assistance from others, b) when development, coaching and coordination are required.
- Coaching: The "Developmental" manager. This manager will motivate employees with providing opportunities for professional development. This is effective when a) skills need to be developed, b) when employees are motivated and wanting development. It is however ineffective when a) the leader lacks expertise, b) when performance discrepancy is too great, c) during a crisis.

Case study: Setting up a business in an area where there are already many competitors is risky, unless you serve a niche market. At a time when circuit boards are being produced cheaply in China in mass quantities, a small Belgian entrepreneur wanted to offer quick delivery of good quality highly customised circuit boards in small quantities with very short delivery times to local manufacturers. He started this in his garage, and gradually bought a new building to further expand. As an enthusiast manager, and coacher, he also decided to employ socially disadvantaged people (minorities, people with disabilities, etc.) and became a very successful commercial social entrepreneur.

6 Costs and cost price in the system of management accounting

6.1. Costs in the system of management accounting

The key factor for the realization of the enterprises that offer goods and services on the European market is their competitiveness. Two major factors that determine the development of a successful business are costs and cost price of production. The information about them is necessary for optimizing the managerial decisions and the achievement of the goals the enterprises have set.

The reporting of costs is a continuous, economic, organizational and technical process whose realization is based on a certain technology supported by a system of methods and means aiming to achieve efficient control on their dynamics. They shall be monitored and managed with a view of their impact on the end financial result.

According to the general regulations of the national accounting standards, "a cost is the decrease of economic benefits throughout the reporting period in the form of outgoing flows or a decrease of assets, or an increase of liabilities, which results in a decrease of the owner's equity and is not related to agreements among the owners of the equity" [11].

The classification of costs is one of the important steps for their efficient management. Grouping them on the basis of one sign or another allows the compilation and systematization of costs with the aim of influencing them through various mechanisms. There are a number of signs on the basis of which costs can be classified. Costs are presented according to the field of activity for which they are made. They can be divided into the following types:

- operative costs;
- financial costs or costs for financial activity/costs for paying off interest, negative differences on operations with financial assets and instruments, negative differences occurring as a result of the change in currency rates when making currency transactions, and other financial costs;

- emergency costs or costs related to emergency transactions/those occur accidentally and arise from events that are not related to the enterprise's usual activity; they are not expected to occur in the near future – divested assets, assets that have been destroyed as a result of natural disasters, etc.

The reporting of costs related to the activity of the enterprise is done firstly, on the basis of economic elements/costs for materials, for outsourcing, for depreciation, for remuneration, for social security and other costs, including taxes and fees; accruals and negative differences resulting from revaluation of assets/, secondly, on the basis of functional purpose. The costs based on economic elements are regulated and they comprise both the costs related to the activity of the enterprise and the costs for organization, management and sales.

Dividing the costs into activities is significant for calculating the cost price of production and for making decisions related to the operative and strategic management of the business. In order to understand how costs function, we shall reveal the reasons which determine them and their relationship with the objects of calculation.

For the purposes of calculating the cost price of production, we shall implement the following classification signs:

- Relevant to the economic nature of costs:
  - material costs: they occur when materialized labour is used in the activity of the enterprise: invested materials, accrued depreciations, etc.
  - labour costs: they reflect the invested human labour. They are measured by the wages, social security and health insurance.
- Relevant to what costs are composed of:
  - single-element (simple) costs: they have homogeneous economic composition – costs for supplies, costs for wages, etc.
  - complex (multi-element) costs: they have heterogeneous economic composition arising from production wastage, costs for organization and management, etc.
- Depending on how costs are included in cost price:

- direct costs: they are directly relevant to the production of a particular product and are directly added to cost price – e.g., the invested materials, the wages, etc. for the production of a particular product.
- indirect costs: they are relevant to the production of several products, activities or objects in the enterprise – e.g., the rent of factory, the costs for electricity for lighting in the factory where several products are manufactured. These are included in the cost price of production by allocating the predetermined base, i.e., indirectly.

- The relevance of the costs ratio to the volume of activity /production/:
  - variable costs: they are directly relevant to the changes in the volume of production costs for materials, fuel, energy, raw materials, etc.
  - fixed costs (by rule): all those costs whose amount is not substantially influenced by the changes in the volume of activity, e.g., costs for management, costs for rent of factory, etc.
- Depending on the role and significance of costs in the manufacturing process:
  - primary (technological) costs: they are directly relevant to the production process and are determined by the technological process; not completing them means no end-product will be manufactured (costs for materials, fuels, etc.)
  - additional costs: they are primarily relevant to the organization, servicing and management of the economic entity.

6.2. Analytical method of studying the relationship profit – fixed costs – variable costs – selling cost of production

Dividing the costs into fixed and variable, based on the volume of production, provides the opportunity for applying the analytical method of break-even analysis. This method is used to study the relationship among profit, fixed, variable costs and the selling cost in order to determine the break-even point of sales where the income of sales covers the costs.

The break-even point is defined in physical units when it comes to single-product manufacturing. In order to determine it, we shall assume that no production is in a warehouse, i.e., production equals sales.

Determining the break-even point can be done analytically, whereby...

the breakeven quantity = fixed costs / (sales price per unit – variable cost per unit)

but it can also be represented graphically as illustrated below.

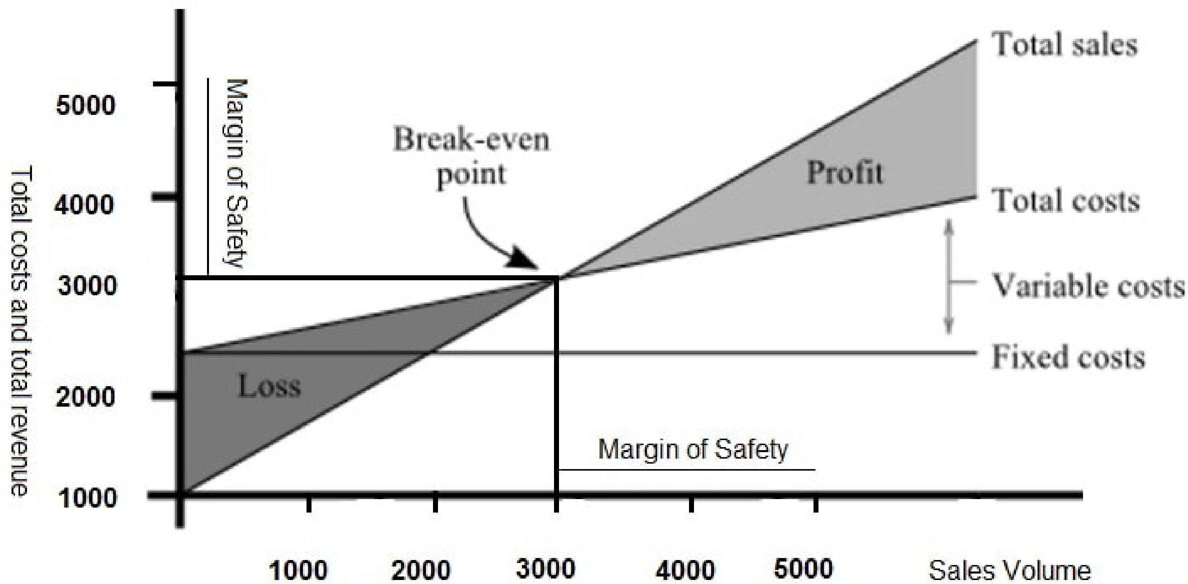

Figure 3: Determining the break-even point of costs [12]

In the figure above, the margin of safety is the margin between the actual/budgeted sales and breakeven point. It denotes the level of safety that company enjoys before incurring losses (i.e. falling below the breakeven level).

IMPORTANT: The Break-even point is difficult to determine in many cases due to market condition that may not remain constant over the range of projected capacity. The total cost line representing the summation of variable costs and fixed costs needs to be a straight line, but actual costs do not usually vary in direct proportion. A Breakeven chart represents a static figure, whereas business operations are not static. The Break-even analysis chart also presents difficulties when an enterprise produces a variety of products.

6.3. Calculation – essence and characteristics

In order to clarify the essence of the process of "calculation" we shall first clarify a number of other notions:

- Object of calculation is the sign which serves as a basis for classifying the costs. It can be a fully or partially completed product, job or service.
- Calculation unit – the measure in which the calculation object is expressed. It does not characterize the economic essence of the object; rather, it serves as its meter – it is determined by its natural and material form. The calculation unit can be natural (physical units – items, people), semi-natural (the results of products of the same consumer quality but of a wider range) or operational (having useful sales area) [13].
- Calculation period – the period for which cost price is calculated. A period of time during which costs are calculated. It depends on the character and organization of activity, as well as the information needs of the enterprise's management.
- Method of calculation – a system of interrelated logical and calculation operation for determining the cost price of the accepted calculation unit for a particular calculation object and the organization necessary for it.
- Calculation – calculation is a technical means which is a product of the process of calculating, material medium of information about the performed logical and calculation processes and end result in determining the cost price.

6.4. Cost price – essence and types

Cost price shows how much a product or service costs the enterprise – its magnitude is formed by the individual costs made for its production/development.

The cost price category can be analyzed in various aspects as for this purpose various classification signs are used:

- Depending on the scope and characteristic of the costs included in costs price, we can differentiate:

  - production (technological) cost price: it is formed by the main production costs (material costs and direct costs for human labour). It does not comprise the costs for organization and management, sales costs, financial and emergency costs. Production is valuated regularly on the basis of its technological cost price.
  - full cost price: it comprises the production cost price plus: costs for organization and management and costs for the sale of production. The full cost price is in the basis of forming the prices of the completed products.
- Depending on the time and method of determining the costs price of production:
  - planned cost price: it is determined at the beginning of a certain planned period on the basis of the so-called planned norms for costs of labour, raw materials and materials for a unit of production.
  - normative cost price: it is determined at the beginning of each month on the basis of the existing norms for costs of labour and material elements in production as of a particular moment.
  - actual cost price: it is determined at the end of each reporting period on the basis of accounting data about the real costs for the production of a particular product or providing a particular service.

6.5. Methods of calculating cost price.

In calculating the cost price of a unit of production, accounting theory and practice offer various methods, approaches and systems. This depends on the type, technology and organization of production, and the applied method of reporting the costs: by orders, by products, by production stages and by activities.

- Job order method of calculation: It is applied for productions with an individual or small series character. Enterprises report the costs for individual orders for each product or a group of products which have been manufactured in small series. The characteristics can be summarized in the following features:
  - analytical reporting of the main production costs by individual types of orders;
  - at the end of the month the unfinished orders are treated as unfinished production;

   - the cost price of the whole product is calculated, not its separate parts and details or stages of production;
   - cost price is calculated after finishing manufacturing the product;
   - the production costs by separate units are summarized, after which the cost price for the whole order is calculated;
   - usually, the manufacturing process and the calculation period are long, sometimes exceeding a one-year period.
- Single-stage (simple) method of calculation: This method is applied in the mass production of homogeneous or narrow range of products with a continuous process of development and most often without the availability of unfinished production. The calculated object is the production. Its essence is expressed in grouping the costs by entries for a given period of time. The sum of the accumulated production costs is divided into the manufactured quantity of production during the corresponding period. The result is the cost price of a unit of production.
- Multi-stage (process-based) method of calculation: It is applied in the mass production of products of one type of output materials and their processing through several consecutive stages when the cost price reflects the separate production stages and the product as a whole. The result of each stage (without the last one) is an input material for the next stage until the end result is achieved. Therefore, new costs are added to the costs of each preceding stage. The costs are reported for each processing stage and for separate types of production. This method has two main varieties:
   - long-stage (semi-finished product): this variety of the method is applied to longer production cycles where the production costs are relatively larger and there is unfinished production. The costs are reported by separate stages and semi-finished products, respectively, products that have been accumulated in total and by homogeneous classification groups [14].
   - short-stage: this variety of the method is applied to shorter technological stages with smaller volume of costs; the results of the separate stages do not function individually and are relatively short in length.

- ABC (activity based costing) method of calculation: It is related to the notion that indirect costs result from a certain type of economic activity. Therefore, the costs entries shall be additionally loaded with those costs which they generate themselves. Here comes the necessity of managing those activities that generate those costs. It is not the costs that shall be managed and controlled, as it is with traditional methods, but the activities that generate them.

  With modern productions, part of the indirect costs is not related to the volume, but to the complexity of the production itself. For each activity there is a major cost-determining factor, which serves as the basis for allocating the indirect costs. In applying the method, first, we shall determine the activities that generate costs: activities during the pre-production stage /the stage of developing the technical and construction preparation of production/; activities on level "separate product" / they generate direct (material) and labour costs, whose change is proportional to the volume of activity/; activities on level "separate batch, separate order" – they generate costs which have a constant character for a specific batch or order/organization of deliveries, control on the quality of production/. Each separate group is made up of activities related to the organization and management of the enterprise as a whole. The costs generated by those activities are mainly wages and social security of the managerial personnel, business trips, heating and lighting of buildings, depreciation, etc. From the point of view of the ABC method, those costs are generated by various reasons and their cost determining factors are hard to categorize. Sometimes, it is impossible to apply to them the principles of allocation which are characteristic of the ABC method. On balance, the methodology for allocating the costs by applying this method comprises: direct addition of direct material and labour costs to the cost price of the product; determining the activities generating indirect costs as well as determining the corresponding cost determining factors; after determining the cost determining factors, we shall proceed with calculating the ratios for allocating the indirect costs to the separate auxiliary and servicing activities.

We can summarize that the ABC method and the traditional methods of calculating the cost price of production shall not be accepted as mutually excluding. On the contrary, it is impossible to unite them and to use the strengths of each of them for achieving the final objective, namely – satisfying the information needs of the management with accurate and reliable information about the cost price of production and services.

7 Cash flow management, tracking and monitoring the spending in a SME

Most start-ups fail for a variety of reasons, but one is far more common than others: running out of money. This is the failing of cash flow within the company. Cash flow management is the process of monitoring, analyzing, and optimizing the net amount of cash receipts minus cash expenses. Net cash flow is an important measure of financial health for any business. To ensure smooth measuring, monitoring and tracking of a cash flow, following steps should be applied.

7.1. Know where you stand

First, the young entrepreneur must know exactly where he/she stands with a cash flow statement. An income statement alone will not provide exact information on a company's cash flow situation. That's because income statements only reveal sales, expenses and profits at a given moment. A cash flow statement, however, shows the movement of money in and out of a business over a specific period of time, whether a week, month, quarter or year. A cash flow statement will show not only what cash is left at the end of the month, but also the amount that entered and left the business. In other words, it will make it easy to see whether you're adding to your business's reserves over time or slowly eroding them. It's important to see this before reserves get too low. Otherwise, a business with many active jobs but lagging receivables can find itself in a bind when it comes to covering unexpected expenses or when the business encounters slow times.

There are some simple balance sheet calculations that can help a business owner interpret his or her cash flow situation. Understanding, for example, how long you're bearing the expense of materials before being paid for them is an important calculation for all kind of businesses. If tracking cash flow seems daunting, then the young entrepreneur may communicate his concerns with his accountant, bank officer, and responsible for corporate clients, as they can provide various financial instruments, even different from a credit line. Another option is to seek for advice from his peers – young entrepreneurs who have experienced similar situations.

Case study: Taking over a family business requires a good understanding of how this business is performing. If many short term loans are required, then there may be an indication that customers pay with a lot of delay, hence creating also problems with cash flow within the business, and unnecessary expenses popping up related to short term credits.

7.2. How do cash flow problems start?

Understanding how cash flow problems occur is crucial to foresee financial challenges or plan ahead. Cash flow problems can arise from end-of-the-business-cycle spending or receiving. Both sources can present problems in a combined manner whereby e.g. spending is extremely high while incomes (receiving) are poor. This can rapidly put your business in financial difficulties. At the spending side, this may occur when your company at its start-up needs to invest in equipment, supplies and labour. However, growth expenditures can quickly deplete precious cash reserves.

Another important element are the basic operational costs which every type of business must cover through both busy and slow times.

Hence, to be viable, a business must have a steady flow of money coming into the business, or reserves will quickly run dry.

Understanding where cash flow problems originate can help you avoid them before they become an issue. If the young entrepreneur knows, for example, that his/her company will soon be facing rapid growth, a slow period or long collection cycles e.g. periodic advances by a contractor, he/she can take measures to combat these situations. E.g. apply strict accounting rules, reducing bad debts (customers with a poor credit record), identify profit problems, ensuring cash flow forecasts are implemented, and avoid growing too quickly as this can cause cash flow issues that can hurt the business.

Case study: A newly set up brand for children clothing had a lot of customers (shop owners, distributors) in its first year, yet, payments arrived very late or were heavily delayed, causing the business to be stalled due to lack of cash flow that could guarantee continuous production. The business nearly folded and had to reduce its size. The fact that production took place in Belgium, also meant production and labour costs were extremely high, compared to cheap low quality import.

7.3. Keep cash flowing

Minimizing business's fixed expenses is crucial in ensuring cash flow is not negatively impacted. For example:

- Find creative ways of handling peaks in demand without incurring unnecessary expenses.
- Hire only the labour you truly need, and make careful decisions about expenses such as equipment purchases, for example.
- One possible strategy for "right-sizing" and minimizing cash needs is to consider renting or leasing equipment instead of buying it outright.

While finding and maintaining the right size of your business is critical to keep expenses down, timing is important as well. There's no way around purchasing the materials needed for projects, but you can delay purchases until the materials are really needed—particularly on long or complex projects or those subject to delays or postponements. Otherwise, precious cash may end up invested in materials that sit unused.

Many expenses must be paid with the financial resources available right at the moment. One way you can even out your business's cash flow is by delaying payment through trade terms with various vendors. Try to negotiate terms that will allow you to defer payment, up to ninety days and reward you with a discount for paying early. Larger, more established businesses will have an easier time negotiating these terms, but small businesses with a good reputation for timely payment will have some room for negotiation with vendors.

Efficiently managing accounts receivable also plays a critical role in maintaining a healthy cash flow.

Case study: A carpenter is undertaking a large roof project, but is stalled by the delay in the wall build up by another company. The carpenter decides not to purchase the required materials yet till he has a better understanding of when he will initiate the roof work.

7.4. Have a fallback plan

Despite the best of plans and most diligent cash management, there may be times when the company needs extra cash, so it's important to have tools on hand for when cash is scarce. You should make sure your company is prepared with several sources of financing in advance.

Some financial institutions may be more likely to extend lines of credit or loans to your company when it is in good financial health, and less likely when cash flow problems have already taken a toll on your finances which is one of the reasons it pays to plan ahead. Once you have credit available to you, use it wisely. Likewise, long-term or secured loans should be used for the purchase of long-term investments.

When seeking financing, be careful not to overlook special lending programs for which your business may qualify, such as those designed to assist small businesses in remote areas, specific sectors (ecology, organic farming), businesses owned by women or certain minorities.

Case study: It is important as a business that you have a good relationship with your "house bank" as they can often offer customised financial tools. And these financial tools can then also be adjusted to the specific industry you are active in.

7.5. Manage growth

Consistent growth is the best way to smooth out bumps in cash flow. When growth opportunities arise, plan carefully with an eye on cash flow predictions. Make a conscious decision about how much you must spend to reach your goal and how long it will be before you pay back the debt.

Every investment, whether in supplies, labour or equipment, should have a clear return. Make sure each earns a profit, but also look at how long it will take to collect them. Likewise, if you look at each customer as an investment with a scheduled return, you'll not only improve cash flow, but also profitability.

Case study: A company's growth is very important; however this growth must be reflected in returns as well. Many companies fail because of bad credit management with customers, whereby too many bad creditors have been given extra credit.

Let's have a look at a concrete example how to calculate the outstanding amount accumulated after the reselling of a good? As illustrated below, the purchase price of a good is 600 units with VAT included, while the reselling price of the same good from the reseller is 864 units. VAT is 20% and 10% is a profit tax, according to the National Tax Regulations.

Purchase price with VAT	**VAT**	**Asset value of the good**	**Reselling price of the good**	**VAT**	**Reselling price- VAT - FIFO value**	**Profit tax**	**Total tax payments**	**Outstanding amount accumulated after reselling, before taxes**	**Outstanding amount accumulated after reselling, after payment of taxes**
A	**B**	**C**	**D**	**E**	**F**	**G**	**H**	**I**	**J**
	20%			20%		10%			
€ 600	€ 100	€ 500	€ 864	€ 144	€ 220	€ 22	€ 66	€ 220	€ 154
	A-A/(1+20%)	A-B		D-D/(1+20%)	D-E-C	F*10%	E-B+G	D-E-C	I-H

At a first glance the amount gained by the reseller is € 264, but in fact the VAT, the profit tax, and the purchase price impact the actual accumulated amounts, after reselling and in our case it is € 154.

The case is a typical example how the actual revenue must be calculated. Many young entrepreneurs make the mistake of not considering part of the elements, connected with the associated profit costs.

8 Realistic behaviour, self-payments

8.1. Go fulltime as entrepreneur or keep a part-time job as backup

As a start-up entrepreneur you should take a well-informed decision at the very beginning: go fulltime as entrepreneur or keep a part-time job as backup.

While some young entrepreneurs have managed to start work on a side business while maintaining their nine-to-five job, such a setup has little potential for long-term success. Whether you've come up with a new idea or you're interested in scaling up one that's already there, eventually you'll need to quit your job to nurture your dream of becoming a successful entrepreneur.

Before doing so however, you need to be sure following elements have been addressed and are in place:

- Make sure your idea is solid and viable.
  - Not every idea is a good idea, and not every good idea is a viable idea.
  - In theory, your business idea might be brilliant, but if it can't be produced effectively or if the market isn't ready for such a solution, even a great idea can fall flat.
  - You need to do some market research. Make a SWOT analysis (Internal: Strength, Weakness; External: Opportunities, Threats) and check if others had a similar idea and what happened to them. Are they still in business? If not, why not?
  - The more data collected ad analysis made, the better.
- Prepare for the realities of entrepreneurship.
  - Entrepreneurship may sound glamorous, however, a majority of start-ups fails. You get to be your own boss, make your own rules and build something unique from the ground up. However, most entrepreneurs end up going back to work.
  - Many successful entrepreneurs spent years developing their ideas, coming to the brink of failure or flat-out failing many times before eventually finding success.

- Entrepreneurship is rewarding, but it's also very, very hard. Read up on the realities of entrepreneurship to be prepared for that [15]:
  - You will find it difficult to make two ends meet initially: Initially things are going to be so tough that you might find it tough to make two ends meet and keep your head above water.
  - Your family won't properly comprehend what you do: Family members might not understand what you are going through and if they find that after a year of struggle you hardly have anything to show for it, they may begin to demoralize you. It is only someone who is an entrepreneur that can really understand what you are going through and can really tell you that yes it is tough in the beginning but don't give up.
  - Be prepared for things to take a long time to materialise, be patient: A business does not become a success overnight. Be prepared that things are going to take possibly twice as long as you initially imagined that they would (permissions take time, certificates need to be obtained, etc.).
  - Never place all your trust and hopes in one contract: A deal or a contract which unofficially seemed to be signed and sealed might not work out the very next day. Disappointments like this will not be easy to accept initially however over time you will realize that the only thing constant in the business world is change and anything can happen at any given moment.
  - Dealing with customers is more difficult than you ever thought: You might have entered this career path as you thought yourself to be a people's person that has a way with words. However, once you actually enter this line and begin to converse with customers and get to know how they really are, you will be in for a rude shock. Since they are paying their hard earned money for products and services they will not be forgiving and the way they speak to you and make demands might not be something which you will be able to take lying down. However, since your business depends on them, you should endure it all.

- You are going to fail: Failure is the stepping stone towards success, however once you decided to be an entrepreneur you have to realize that failure is not something that will take place once or twice in your career. If you do not want to be in a for a shock, then you ought to mentally prepare yourself for the fact that you will be facing multiple failures on a daily basis and things will not go in your favour at all. Even then you should not let any of these things affect you physically, mentally or emotionally.
- Working with friends is always a bad idea: You might have thought that when you become an entrepreneur working with your friends is something that you will love doing as they will always be there to guide you and help you along the way. However, working with friends is something that hardly works out and when even the best of friends are unable to see eye to eye on business decisions then their relationship could easily go sour. So this is indeed a harsh reality which is all part and parcel of becoming an entrepreneur. You might additionally also find it very challenging to pull up your friends for doing something wrong.
- If the idea gets you no money, it's not a good idea: Entrepreneurs come up with ideas after a great deal of effort. Over time an idea which you conceived might become a part of you and no matter what, you would like to watch it succeed. One of the harsh realities of becoming an entrepreneur is that sometimes an idea may look good on paper but it just might not work out for reasons you might not be able to comprehend. Give it time, however you should be able to know when to let go and put the efforts to rest. Remember it may be a good idea, but if it's not making you any money, then what's the point?
- If you start something you are not passionate about, it will end in failure: A harsh reality about being an entrepreneur is that if you are not truly passionate about your business it will not take off. If you are genuinely passionate about something, then only will you really be able to put your

mind into trying to make it a success. Be an entrepreneur because it is your dream to become one, and not because someone is forcing you to become one. Things will never work out if you feel like it is a burden to you. If you are truly passionate about this line you will think of each day as a new adventure before you, waiting to be explored.

- The work will always be never ending: Being an entrepreneur implies that you will have no fixed hours of work. Be prepared for the fact that sometimes you will have sleepless nights as well. Just because one of your ideas has been a success that does not mean that you can take the next few weeks off and bask in your glory. The key to being a good entrepreneur is that you are constantly on your feet thinking of ways in which you can take your business to greater heights by looking into things like the services which you provide, the feedback of customers and the quality of the products which you sell.
- Hiring loyal employees is a tough task indeed: The task for hiring employees is something which you will find most challenging. There are many people who will tell you they are qualified and able, when they are actually not and there will be others who will leave you, the moment they realize that they have better options elsewhere. So what you must do as an entrepreneur is try your best to ensure that your employees are happy and content. The smaller the team you have, the better it is for you as you will be able to keep your expenditure to a minimum as well.
- You cannot trust anyone: When you are an entrepreneur initially you might find yourself at sea, yet one of the biggest mistakes you are likely to make is being too trusting whether it is with an employee or a partner. No matter what, you should never share too many business secrets with anyone because in the business world no one is your friends and they might betray your trust in a terrible manner at a time when you least expected it.

- You will have to deal with a lot of criticism and various opinions: The truth and hard reality of being an entrepreneur is that there will be many people who will always be trying to give you their opinions and criticisms whether you asked for their thoughts or not. Sometimes it is okay to take into account valuable criticism which is being given, yet sometimes since you are the captain of the ship, you ought to trust your own instincts and abilities because trying to cater to too many wants as well as needs will confuse you. Keeping things simple and not listening to those that are trying to tear you down will help you along the way.
- Having a partner could be one of two things: A harsh reality of being an entrepreneur is that choosing to have a partner could be one of two things. Either it could be the best decision or worst business related decision which you made. You should keep your mind when deciding on whether your business needs a partner or not.
- Having a personal life is nearly impossible: When you become an entrepreneur, be prepared to kiss your personal life good bye. Your primary focus in the initial years of your entrepreneurship should always be your business. You might have to put a number of things in your life on hold that is why you might find that when you choose to become an entrepreneur and start working towards achieving your dream you will lose some friends along the way. Yet those who want to be in your life will understand and try to find a way to always support you.
- When you become successful people will grow jealous: As you become successful many people who you thought would be happy for you will grow incredibly jealous of all that you have achieved. But you should not get such negativity get to you and when you have worked hard you should not feel bad about yielding rich dividends. However, make sure that at no point in time do you let any of your success go to your head and change you to someone who is proud and egoistic.

        - It is unlikely that you will ever feel like retiring: One harsh reality which you need not worry about when you are young is that once you have grown older and tasted entrepreneurial success it is unlikely that you will ever feel like retiring, yet you should know when it is time to give up and when to pass on the torch to your prodigy.

- Establish a personal financial plan
    - Quitting your job means your main line of sustainable income will disappear. Your personal finances need to be in immaculate order before you allow that to happen. Even if your business idea is great and viable, it may still be months or years before you can draw any meaningful revenue or income from it. Even then, your revenue will probably be minimal and inconsistent.
    - To prepare for this, take a look at exactly how much money you need to continue your current lifestyle and how much money you have. Can your savings totally sustain you for a year or more? What backup options do you have if you do run out of money?
- Talk to people
    - Ultimately, quitting your job has to be your decision. But before you pull the trigger, it's worth your time to talk to others about your options. Talk to your spouse about whether he or she is ready to take the risk with you. Talk to your friends about whether they believe your idea is promising. Talk to your peers and mentors to see if they have any advice.
    - You may find these alternative perspectives illuminate problems you didn't know were there or help to put your mind to ease.
    - Select the correct company model.
    - When setting up a business, you want to limit the risk that in case of failing, your personal assets would also be involved. To avoid such risk, a company with limited liability is most desirable. Although it may end up be quite expensive to set up, in the end it does protect you against claims by suppliers in case your company becomes a failure.

- Select the supporting accountant
  - Don’t go cheap when it concerns accountants. A good accountant does not come cheap, but does ensure you will have an in-depth understanding of your financial situation via the analytical accounting principles. Going Dutch in this domain may turn out to be a very expensive mistake.
  - Some tips:
    - Separate business and personal expenses
    - Track every business expense
    - Accurately record income
    - Consider hiring a professional, even if temporarily
    - Automate accounting practices with accounting software
    - Dedicate time to update your books
    - Keep tabs on labour costs
    - Be prepared for major expenses
    - Maintain inventory records (if relevant)
    - Follow up on invoices and receivables to avoid overpaying on taxes
    - Create financial projections for future years
  - If an accountant is too expensive, consider outsourcing it.
- Maintain the bridge
  - Once you’ve decided to move forward and quit your job, the last step is to quit your job in the right way. Never, ever burn a bridge in the professional world. There’s a chance your idea won’t pan out and you’ll need to come back, and there’s also a chance your idea will become a success and you’ll want to work together with your former employer in a mutually beneficial relationship.
  - Talk to your employer candidly about leaving, give them as much time as they need to find a replacement and exit as smoothly as possible to preserve your relationship.
  - Once you’ve completed these five steps and you still feel good about leaving to become a full-time entrepreneur, there’s nothing that should stop you from

quitting your job. It's an exciting time, and making quick, impulsive and risky decisions is part of being an entrepreneur anyway, but that extra degree of preparedness can help prevent or mitigate an unfortunate end to an otherwise promising story.

8.2. Financial viability of the business model, using financial ratios

As young entrepreneur you should review the financial ratios on a monthly basis to keep on top of changing trends in the company. There are 4 basic ratio categories.

- Liquidity (working capital) ratios: These ratios measure the amount of liquidity (cash and easily converted assets) that the entrepreneur has to cover the debts. They provide a broad overview of the financial health and measures the company's ability to generate cash to meet the short-term financial commitments. It is calculated by dividing the current assets (cash, inventory and receivables) by current liabilities (line of credit balance, payables and current portion of long-term debts).
    - The quick ratio, also known as the acid-test or liquidity ratio, measures the ability of a business to pay its short-term liabilities by having assets that are readily convertible into cash, and thus access cash quickly to support immediate demands. The quick ratio divides current assets (excluding inventory) by current liabilities (excluding current portion of long-term debts).

      QR = (current assets – inventories – prepaid expenses) / current liabilities

        - A ratio of 1.0 or greater is generally acceptable, but this can vary depending on the industry.
        - A comparatively low ratio can mean that the company might have difficulty meeting the obligations and may not be able to take advantage of opportunities that require quick cash. Paying off liabilities can improve this ratio; one entrepreneur may want to delay purchases or consider long-term borrowing to repay short-term debt. The entrepreneur may also want to

review the credit policies with clients and possibly adjust them to collect receivables more quickly.

- A higher ratio may mean that the capital is being underutilized and could prompt to invest more of the capital in projects that drive growth, such as innovation, product or service development, R&D or international marketing.
- What constitutes a healthy ratio varies from industry to industry? For example, a clothing store will have goods that quickly lose value because of changing fashion trends. Still, these goods are easily liquidated and have high turnover. As a result, small amounts of money continuously come in and go out, and in a worst-case scenario liquidation is relatively simple. This company could easily function with a current ratio close to 1.0. On the other hand, an airplane manufacturer has high-value, non-perishable assets such as work-in-progress inventory, as well as extended receivable terms. Businesses like these need carefully planned payment terms with customers; the current ratio should be much higher to allow for coverage of short-term liabilities.

- Efficiency ratios: Often measured over a 3- to 5-year period, these give additional insight into areas of the business such as collections, cash flow and operational results.
  - Inventory turnover looks at how long it takes for inventory to be sold and replaced during the year. It is calculated by dividing total purchases by average inventory in a given period. For most inventory-reliant companies, this can be a make-or-break factor for success. After all, the longer the inventory sits on your shelves, the more it costs. Assessing the inventory turnover is important because gross profit is earned each time such turnover occurs. This ratio can enable to see where the entrepreneur might improve his/her buying practices and inventory management. For example, one could analyze purchasing patterns as well as clients to determine ways to minimize the amount of inventory on hand. This ratio can also help see if the levels are too low and the missing out on sales opportunities.

  - Inventory to net working capital ratio can determine if the entrepreneur has too much of working capital tied up in inventory. It is calculated by dividing inventory by the total current assets. In general, the lower the ratio, the better. Improving this ratio will allow you to invest more working capital in growth-driven projects such as export development, R&D and marketing.
- Profitability ratios: These ratios are used not only to evaluate the financial viability of the business, but are essential in comparing business to others in the industry. One can also look for trends in the company by comparing the ratios over a certain number of years.
  - Net profit margin measures how much a company earns (usually after taxes) relative to its sales. A company with a higher profit margin than its competitor is usually more efficient, flexible and able to take on new opportunities.
  - Operating profit margin, also known as coverage ratio, measures earnings before interest and taxes. The results can be quite different from the net profit margin due to the impact of interest and tax expenses. By analyzing this margin, one can better assess the ability to expand a business through additional debt or other investments.
  - Return on assets (ROA) ratio tells how well management is utilizing the company's various resources (assets). It is calculated by dividing net profit (before taxes) by total assets. The number will vary widely across different industries. Capital-intensive industries such as railways will yield a low return on assets, since they need expensive infrastructure to do business. Service-based operations such as consulting firms will have a high ROA, as they require minimal hard assets to operate.
  - Return on equity (ROE) measures how well the business is doing in relation to the investment made by its shareholders. It tells the shareholders how much the company is earning for each of their invested €s. It is calculated by dividing a company’s earnings after taxes (EAT) by the total shareholders’ equity, and multiplying the result by 100%.

- Leverage ratios: These ratios provide an indication of the long-term solvency of a company and to what extent you are using long-term debt to support your business.
    - Debt-to-equity and debt-to-asset ratios are used by bankers to see how your assets are financed, whether it comes from creditors or your own investments, for example. In general, a bank will consider a lower ratio to be a good indicator of your ability to repay your debts or take on additional debt to support new opportunities.

Case study: A Belgian entrepreneur set up his own company, but due to the expenses of a Company Limited status, set up a cheaper company format but with unlimited liability. The company was specialised in detailed interior design. Due to an accident that occurred at the workplace, he became unable to work. The company soon folded due to lack of income and left a € 500000 financial hole. Having no protection against claims on his personal assets, as well as those of his wife, they lost everything. At this moment they still owe € 250000. To repay the debt, their current salaries are skimmed automatically, leaving them with a mere € 54 per week to buy food, etc. Their case was featured by the Flemish VRT TV channel, demonstrating how people can become entirely impoverished after a business failure in case liabilities are unlimited.

Conclusion

This handy booklet provided an introduction to the many facets of management accounting. To go even deeper into this topic, we recommend you access our training courses at https://management-accounting.eu/elearning/. You will find there also a range of tools to support you in calculating your ...

- activity based costing
- cost-plus pricing
- net present value

but also in creating your...

- Balanced scorecard
- SWOT analysis
- PESTLE analysis

The same tools and course content can also be reached via our mobile apps:

- https://play.google.com/store/apps/details?id=com.y4baccounting.mobile
- https://apps.apple.com/app/id1560803739

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