

Think Critically

1. What are some ways you can improve your cash flow?
2. Why is it important for an entrepreneur to analyze the financial statements of the business?
3. What would be the benefit of preparing an income statement monthly instead of once a year?

True or False

- ____ 1. A cash budget is based on past revenues and will show the projection of incoming cash.
- ____ 2. If your cash receipts will not cover your expenses, you can try to increase the cash coming into your business.
- ____ 3. To encourage customers to pay more quickly, you can offer discounts on bills paid immediately.
- ____ 4. Reducing your payroll expenses by laying off workers can improve your cash flow.
- ____ 5. You can reduce fixed expenses to improve your cash flow.
- ____ 6. Dividing total sales by the sales of a specific product gives the percent of sales accounted for by that product.
- ____ 7. Net sales is the dollar amount of all sales, including sales that have been returned.
- ____ 8. The profit ratio for a business can be compared to the average profit ratio for the industry.

Multiple Choice

- ____ 1. Offering discounts on bills paid right away will (a) increase your cash receipts, (b) get customers to pay more quickly, (c) reduce your accounts receivable, (d) all of these.
- ____ 2. You can reduce your disbursements by (a) holding more inventory, (b) adding to your payroll, (c) paying your bills more promptly, (d) none of these.
- ____ 3. Reducing your inventory will (a) decrease your accounts payable, (b) increase your accounts payable, (c) decrease your accounts receivable, (d) not improve your cash flow.

- _____ 4. Analyzing your sales by product can help you (a) determine the amount of income tax to pay, (b) find the breakeven point, (c) make decisions about what kind of inventory to stock, (d) determine whether or not your business is earning a profit.
- _____ 5. All of the information necessary for calculating net profit on sales is found on the (a) cash flow statement, (b) balance sheet, (c) income statement, (d) inventory record.
- _____ 6. What must be subtracted from net sales to find gross profit? (a) Cost of goods sold, (b) Operating expenses, (c) Total expenses, (d) Interest expense.
- _____ 7. Net profit on sales is equal to net income after taxes divided by (a) gross sales, (b) cost of goods sold, (c) net sales, (d) none of these.
- _____ 8. The volume of sales that must be made to cover all the expenses of a business is (a) the breakeven point, (b) impossible to determine, (c) net revenue from sales, (d) the profit point.
- _____ 9. You can increase cash receipts by (a) establishing tighter credit policies, (b) following up on unpaid accounts receivable, (c) holding shipments to customers with unpaid bills, (d) all of these.
- _____ 10. The net-profit-on-sales ratio determines (a) cash flow, (b) the breakeven point, (c) business profits, (d) interest expense.

Problem Solving

1. Complete the following income statement.

Revenue from sales	
Gross sales	\$183,000
Returns	\$1,900
Net sales	
Cost of goods sold	\$74,400
Gross profit	
Operating expenses	
Salaries	\$32,400
Advertising	\$1,200
Rent	\$12,000
Utilities	\$900
Insurance	\$1,200
Other	\$780
Total expenses	
Net income from operations	
Interest expense	\$3,600
Net income before taxes	
Taxes	\$13,350
Net income after taxes	

2. Use the income statement from Question 1 to compute the net profit on sales ratio. Show your work in the space below.

what went wrong?

TOO BIG, TOO FAST

Webvan was founded in the late 1990s by Louis Borders. Webvan was an online grocery ordering and delivery service. Initially, customers were excited about this service that was offered in nine U.S. markets. The company's long-range plans included expansion into 26 cities. The company started with hundreds of millions of dollars from private investors and then raised \$375 million in its initial public offering of stock. At one time, Webvan was worth \$1.2 billion, but all was not



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Too many cash disbursements can lead to business failure.

well in the Webvan world. Customers did not sign up as founders hoped they would. But the biggest problem Webvan faced was rapidly disappearing cash reserves. It placed a \$1-billion order to build high-tech warehouses,

bought a fleet of delivery trucks, and purchased state-of-the-art computer systems. The management team of Webvan did not have anyone with any experience in the grocery market, and it tried to get too big, too fast. Even though customers were not happy with long lines and the quality of products in traditional supermarkets, they did not flock to the online grocery store. In less than two years after its successful initial public offering, Webvan announced it was closing.

THINK CRITICALLY

1. What are some of the problems Webvan faced during its short-lived operation?
2. Webvan started with a large amount of cash reserves. What caused Webvan to end up with cash flow problems?
3. What changes in operations do you think Webvan could have made that might have helped it be successful?