Training on Entrepreneurship Development

Measures of Profitability in a business

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14 – 17 Dec, 2015

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Income Statement

	$
• Sale	xxx
• (-) Cost of Sale	(xx)
• Gross Profit	xxx
• Operating Expense	(xx)
• Operating Profit	xxx
• Financial Expense	(xx)
• Net Profit	xxx

Balance Sheet (Accounting Equation)

- Assets = Liabilities + Equity
- Assets → Fixed Assets, Current Assets
- Liabilities → Long-Term Liabilities, Current Liabilities

Return on Investment (ROI)

- ROI = $\dfrac{\text{Operating Profit}}{\text{Total Investment}} \times 100 = \%$

ROI and the Age of non-current asset

- increase year by year as the assets get older.
- can give a false impression of improving performance over time.
- Disincentive to investment center managers to reinvest in new or replacement assets

	P	Q
	$	$
Non-current assets	60	220
(230 – 170) (230 – 10)		
Working capital	20	20
Capital employed	80	240
Profit	$24	$24
ROI	30%	10%

Conclusion

P has performed much better than Q. However this comparison would not be fair because the difference in performance might be entirely attributable to the age of their non-current assets.

CASH FLOW FOR FINANCIAL PLANNING

- TOTAL CASH INFLOW
  - Inflow funds
  - Inflow operation
  - Other income
- TOTAL CASH OUTFLOW
  - Increase in fixed assets
  - Increase in current assets
  - Operating costs
  - Marketing costs
  - Income (corporate) tax
  - Financial costs
  - Loan repayment
  - Dividends
  - Equity capital refund
- SURPLUS (DEFICIT)
- CUMULATIVE CASH BALANCE

CASH FLOW FOR FINANCIAL PLANNING

TOTAL CASH INFLOW

- Inflow funds
  - Total equity capital
  - Total long-term loans
  - Total short-term finance
- Inflow operation
  - Sales revenue
  - Interest on short-term deposits
- Other income

CASH FLOW FOR FINANCIAL PLANNING

TOTAL CASH OUTFLOW

- Increase in fixed assets
  - Fixed investments
  - Pre-production expenditures (net of interest)
- Increase in current assets
- Operating costs
- Marketing costs
- Income (corporate) tax
- Financial costs
- Loan repayment
- Dividends
- Equity capital refund

CASH FLOW FOR FINANCIAL PLANNING - SUMMARY LINES

TOTAL CASH INFLOW

- TOTAL CASH OUTFLOW

= SURPLUS (DEFICIT)

CUMULATIVE CASH BALANCE

Foreign surplus (deficit)

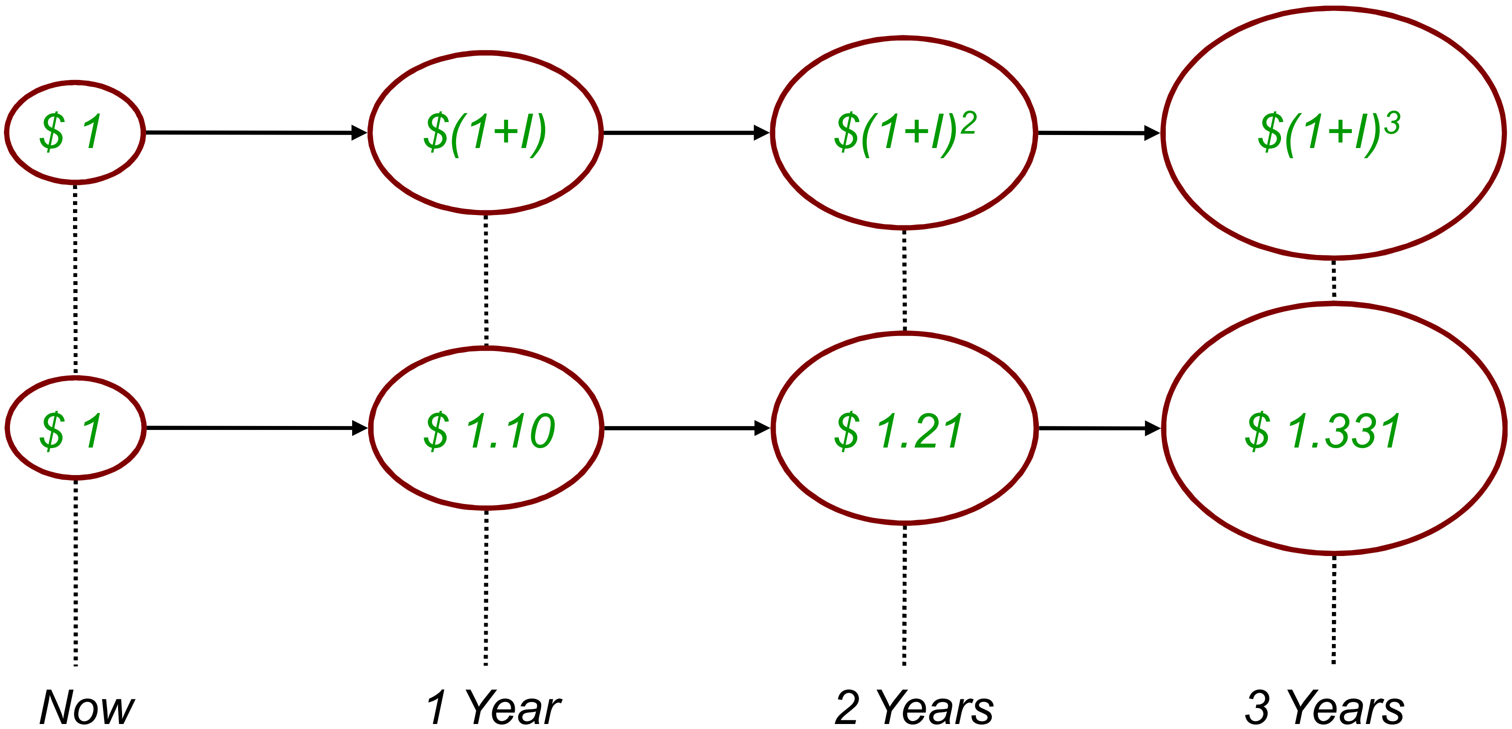
Local surplus (deficit)

Foreign cumulative cash balance

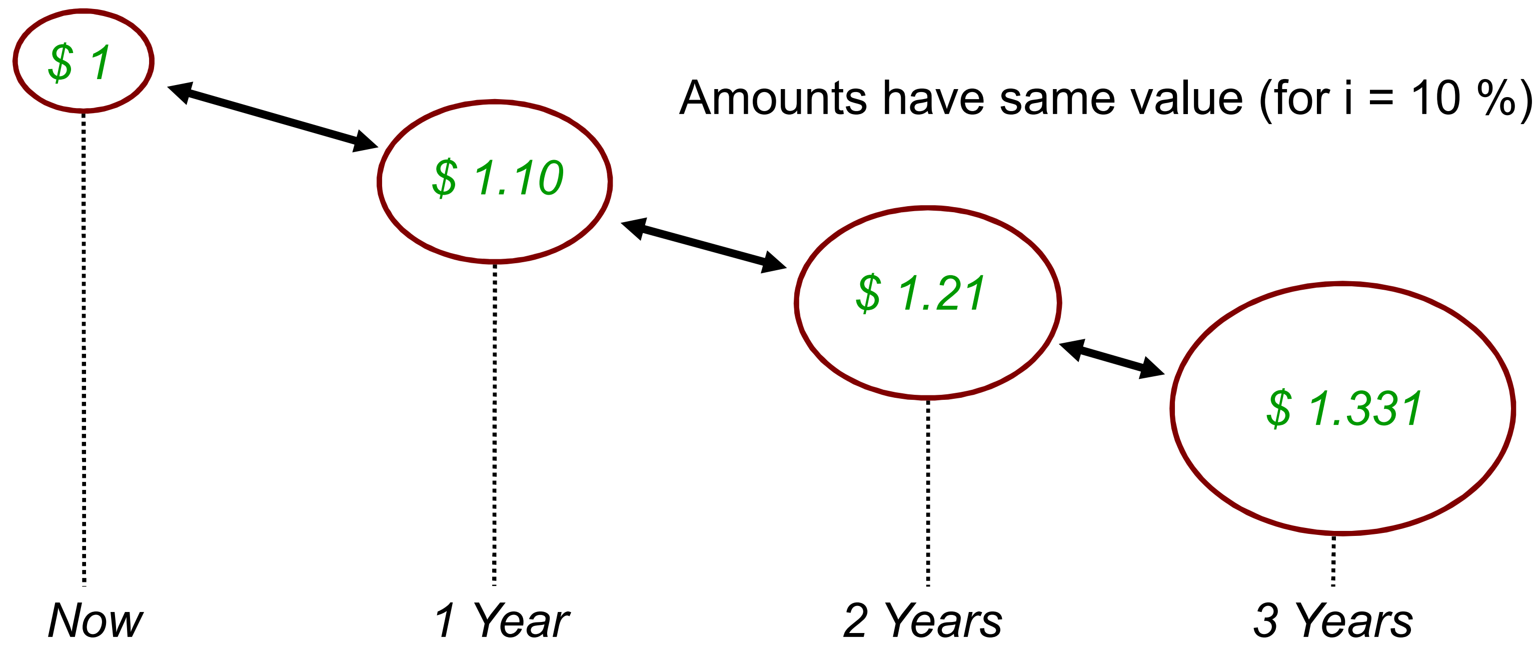
Local cumulative cash balance

Net flow of funds

COMPOUNDING GROWTH



TIME VALUE OF MONEY



DISCOUNTING

$ 1	= $ 1.10		
$ 1		= $ 1.21	
$ 1			= $ 1.331
$ 0.909	= $ 1		
$ 0.826		= $ 1	
$ 0.751			= $ 1
Now	*1 Year*	*2 Years*	*3 Years*

- Compounding

$$A = PV(1 + r)^n$$

- Discounting

$$PV = \frac{A}{(1 + r)^n}$$

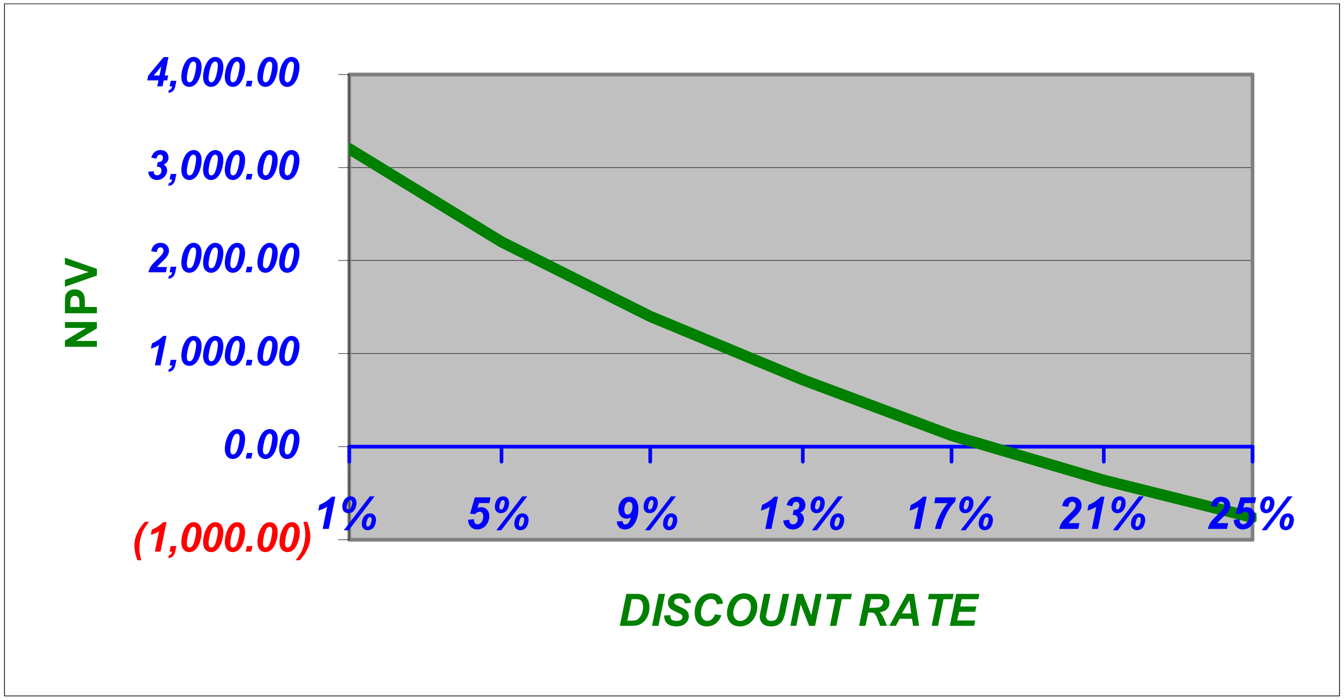
Net Present Value

- It is the difference between present value of inflow and present value of outflow.
- If it is positive, the project is worthwhile.

Internal Rate of Return

- The Rate at which the Net Present Value (NPV) is zero.

NPV PROFILE


4,000.00
3,000.00
2,000.00
1,000.00
0.00
(1,000.00)
NPV
1%
5%
9%
13%
17%
21%
25%
DISCOUNT RATE

Break Even Point