

Relevant cost and financial ratio principles applied in a small business

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President Thomas Jefferson wrote:

"The God who gave us life gave us liberty at the same time" and asked "Can the liberties of a nation be secure when we have removed a conviction that these liberties are of God?"

The Bible says:

"It is better to **trust** the LORD than to put confidence in man" (Psalm 118:8).

To HIM all the Glory! Amen

ABSTRACT

Cost-Volume-Profit (CVP) analysis and financial ratios are all **managerial accounting** and **financial accounting** tools that can help managers to make informative business decisions within their organisations. In addition, certain **strategic** tools such as Porters five forces, SWOT analysis, identifying of core principles, the compilation of the vision and mission statement will empower the small to medium business to be successful as an entrepreneurial venture.

The problem arises in many small to medium business (SMEs), that once growth occurs and important decisions needs to be made, which may include relocation of the business and buying of capital equipment. The owners of these ventures struggle to make informative decisions.

The general objective of this research is to apply financial and managerial accounting principles as well as strategy principles to a small business called Envirocare Laboratories. The aim of this research is to empower the small business owner with these tools to ensure success in future ventures.

Literature on financial, managerial and strategic principles advises that the objectives, measurements and targets should be aligned with the SMEs long-term goals and performance.

An empirical study done with the owner of the SME called Envirocare, has indicated serious shortcomings in terms of understanding how long-term goals are defined and the objectives achieved. The most important conclusion includes that certain capital expenditure projects have been viable, that the SME has been adding value to the economy and that the current strategy needs to be revised to include long-term goal planning.

Keywords: micro-biology industry, SME, strategy, micro-laboratory industry, financial ratios, managerial accounting and financial accounting tools

LIST OF ABBREVIATIONS

SME = Small to Medium Enterprise

FC = Fixed Cost

VC = Variable Cost

ROA = Return on Assets

ROE = Return on Equity

GP = Gross Profit

OP = Operating Profit

NPM = Net Profit Margin

OR = Operating Return

WC = Working Capital

FCF = Free Cash-Flow

CVP= Cost-Volume-Profit

CF = Cash-Flow

CBD = Central Business District

EBIT = Earnings before Interest and Taxes

EPS = Earnings per Share

SWOT = Strengths, Weaknesses, Opportunities, Threats

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CHAPTER 1

NATURE AND SCOPE OF THE STUDY

1.1 INTRODUCTION

The micro-laboratory industry in South Africa consists of a variation of laboratories varying in size from very big to very small. However, there are a few big companies that dominate the market. The micro-laboratory industry has started to boom around 15-18 years ago, when legislation changed during the transition to the new democratic order that has been established. A need for laboratories to monitor and control micro-biological activity within our stricken water resources as well as the food industry, has led to the establishment of a few big laboratories. Due to demand a few smaller based laboratories that are customer based, has sprung to life.

Envirocare Laboratories is a small family owned business which has grown from a turnover of R120 000 per annum in 2007 to approximately R1 800 000 per annum in 2011. This growth has taken place without any formal planning or strategy. Most growth took place through customers who marketed the good business support by “word of mouth” communication.

Envirocare has utilised a small micro-laboratory (4m²) at the North-West University. A nominal rent has been charged by the university.

Since its inception, not one cent was borrowed from financial institutions and Envirocare has shown a profit on the books since day one. In 2010, Envirocare has acquired property within the central business district of Potchefstroom. This property has zoning rights and the main objective of the acquisition was to increase growth via fixed assets.

An interesting problem has confronted Envirocare in recent months. The demand from customers and the increase in growth of their customer base, have led to the maximum capacity utilisation of the small micro-laboratory.

1.2 PROBLEM STATEMENT

Managerial accounting principles, financial ratios and a good selected strategy are sometimes neglected in medium and smaller businesses. These shortcomings can lead to business decisions being made on the "gut feel principles" instead of applying managerial principles, financial ratios and medium to long-term strategies. As a result, expected growth may be hampered, or the unexpected positive growth from a certain industry or area could lead to the destruction of these medium to small businesses. There are no clear guidelines to establish prices for products and services in the micro-laboratory industry. The only guidelines for micro-laboratories received, are set by SANAS (South African Notional Accreditation System), which include ISO/IEC 17025:2005 standards. These standards adopt general requirements for the competence of testing and calibration of laboratories.

Envirocare laboratory has a capacity problem. The laboratory needs a larger facility from where it can operate. The owner of the laboratory is aware that by moving to a larger facility, certain financial risks will be introduced by means of an increase in cost. The only way to control these risks is to apply certain managerial principles, which include the relationship between relevant cost and cost behaviour and cost-volume-profit analysis. In addition, financial ratios will show whether the business in question is in a good financial position. Strategy will give meaning and direction to the small business.

No research, specifically in this field, has been done, which the small business owner could benefit from. Studies that in some way are related to this topic, completed in the past, include the following:

- Establish to what extent Small and Medium Enterprises (SMEs) in the Port Elizabeth CBD comply with good governance principles and practices (M. Dumisani, 2005).
- The objective of the above mentioned study was to establish to what extent Small and Medium Enterprises (SMEs) comply with good governance principles and practices. In this particular research, SMEs in the Port Elizabeth area were

chosen as the representative population of the SME sector in the ZAR. The conclusion reached was that the majority of SMEs globally did not comply with good governance principles.

- Value management developing organisational readiness for value creation: a case study (JP da Molta, 2002).

The objective of Da Molta's study was to focus on the management of value, with the emphasis on human and structural capital. Companies are finding that their human capital often has the potential to create far greater value than their financial capital. This is evident of small to medium enterprises.

The chosen research will be to determine whether Envirocare (within the micro-laboratory field) has the:

- Financial means to move to a new premises as well as establishing the required growth rate needed to be a profitable establishment in the future;
 - To determine this, the researcher will make use of managerial accounting principles, such as relevant cost and cost-volume-profit.
 - In addition, certain financial ratios will be used to determine the financial capacity of the SME in question.
- Ability to move to the new premises, because certain sunken costs will occur. In order to provide for these costs, the SME will need a strategy to implement measures that will ensure that value creation is added and that the SME is sustainable in the long run.

1.3 OBJECTIVES OF THE STUDY

The research objectives were divided into a primary objective and secondary objectives.

1.3.1 Primary objective

The primary objective of this study is to determine whether this small business will benefit by moving to the new designated premises, and whether this small business can sustain such an endeavour. Once this small business has moved to the new premises, the cost to sustain profitability will be calculated by using managerial accounting principles. Thus a profitability analysis needs to be done to determine how much and by how many customers this small business needs to grow to ensure that value is added to the community as well as the environment. A clear strategy will be implemented to guide the small business owner in her endeavours.

1.3.2 Secondary objectives

The secondary objective of this research is twofold. Firstly, a literature study will be done on three different categories, namely financial ratios, managerial accounting principles and strategy principles. To clearly understand the literature study, it will start with the following as background information:

- Defining a small to medium based enterprise (SME).
- Describe the micro-biology industry.
- Define the flow of money.

Financial ratios will be explained as a means to determine the profitability of the business. Managerial accounting principles which will include relevant cost, cost behaviour and cost-volume-profit analysis will be clearly defined. A clear strategy will be explained for the small business to ensure that the future of the business is directed in the desired direction. This strategy will include the five forces of Porter, defining core principles as well as a SWOT analysis.

As part of the second objective, an actual empirical research on the case study, Envirocare, will be done via an interview and analysing the financial statements. By studying the financial statements which will include the income statement, balance sheet and cash-flow statement, limitations within the business will be identified. Financial ratios will be used to determine if this small

business is functioning as a profitable unit. Managerial accounting principles will determine whether the business does have the capacity to relocate. The current business scenario (strategy) will be researched and exploited. This will be done via an interview with the business owner. Shortcomings within this small business will be identified. The five forces of Porter will be introduced within the SME. In addition, a SWOT analysis will be done on the SME to determine strengths, weaknesses, opportunities and threats for this type of SME. Within this scope of study an analysis projection will be made to the business owners on how to run their business in a more profitable manner.

1.4 SCOPE OF THE STUDY

The coverage and extent of the study is to use a small micro-laboratory business, called Envirocare, as example. Envirocare is situated at the North-West University, Potchefstroom Campus, in Potchefstroom, North West Province. The laboratory is currently renting a small micro-laboratory from the North-West University. In 2010, Envirocare acquired property with business rights in the CBD of the town. The owner wants to relocate the business from the North-West University to the new facility. This facility has the advantage that it is much bigger than the current location. Currently the micro-laboratory is running at maximum capacity. By moving to that larger facility, the expectation of customer and sales growth could become a reality. However, this opportunity should be carefully investigated to ensure that fixed and variable cost do not increase to such an extent that a negative profit margin is established. This could have a negative impact on the company as a whole and could even lead to bankruptcy. To ensure that the decision to relocate the laboratory is a well informed decision, certain managerial accounting principles should be implemented in the company, including behaviour cost, relevant cost and cost-volume-profit principles. This will help the small business owner to make a clear and logical decision on whether the current premises should be exchanged for a bigger facility which could ensure a steady growth in sales. The financial ratios will help the small business owner to determine whether her current financial position is positive enough to relocate the business. The strategy to be proposed

will guide and lead the small business owner in implementing medium and long-term goals for the business.

1.5 RESEARCH METHOD

The research study pertaining to the specific objectives consists of two phases, namely a literature study and an empirical study.

1.5.1 Phase 1: Literature Study

A literature study will be done on the following topics which will give a clear indication on what is required to understand the problem statement. The following objectives include:

- Defining a small to medium based enterprise (SME).
- The reason why people start small to medium businesses.
- Problems associated with small to medium businesses (SME).
- The Micro Biology industry.
- Defining cash-flow management.
- The flow of money and how it is managed.
- Financial management principles.
- Managerial accounting principles.
- The strategy of SMEs.

To answer these questions, a variety of resources need to be visited. The literature study will include resources such as articles, journals, the internet and relevant dissertations on these subjects. The relevant subjects include behaviour cost, relevant cost and a cost benefit analysis. Certain financial ratios but not all will be used to determine the value currently added to the economy.

To determine a strategy for this SME, the researcher will investigate “The Five-Forces Model of Competition” which is an analytical tool to determine the nature and strength of competitive pressures in a given industry. The SWOT analysis is a simple but powerful tool for sizing up a company’s strengths and

weaknesses, its market opportunities, and the external threats to its future well-being.

1.5.2 Phase 2: Empirical Study

This study will comprise of applied research on the company called Envirocare, to evaluate objective data which will consist of the existing financial statements (cash-flow statements, income statements and balance sheet). These statements will be used to determine certain financial ratios/calculations. The financial ratios/calculations, behaviour cost, cost-volume-profit and relevant cost calculations will give an in-depth insight into the current state of affairs of this small business.

In addition, an interview will be conducted with the business owner. The interview will focus on the following,

- The Micro Biology industry.
- How the business owner interprets financial statements.
- How the business owner interprets managerial accounting principles.
- How the business owner interprets business strategy.

Once this information has been studied, certain projections and recommendations will be made to the owner of this small business. The next phase will be the implementation of these recommendations to ensure that this small business is run according to good financial principles.

1.6 LIMITATIONS OF THE STUDY

Limitations of the study will comprise of the fact that only one small business will be used as an example.

1.7 CONTRIBUTIONS OF THE STUDY

The aim of this study will ultimately be to set managerial accounting guidelines, financial ratios and strategy principles in action and to assist SMEs in the micro-laboratory industry. These guidelines will ensure that the SMEs will be able to make better decisions regarding managerial and financial management as well as business strategy. Some of the guidelines may include the following:

- Guidelines on how to use financial ratios in determining value creation.
- Guidelines on how to use managerial accounting principles in making informative capital expenditure decisions.
- Guidelines on how to use strategy as a tool to apply and to improve capability in decision-making processes.

CHAPTER 2

LITERATURE STUDY

2.1 INTRODUCTION

As indicated in the previous chapter, Envirocare Laboratories is a SME located at the North-West University. The owner of the business has been confronted by a capacity problem recently. A new premises which will serve the requirements of the business, has been identified. However, in the past, the SME never borrowed funds from financial institutions, nor from private money-lenders. The small business was adding value from day one and the owner wants to keep it that way.

The researcher will identify certain ingredients of success within the SME. The researcher will try to answer the concerns of the owner of the micro-laboratory, by interviewing the owner, studying various financial reports and analysing data from income statements, balance sheets and cash-flow statements.

Certain principles are needed to investigate this SME. These tools include aspects of:

- **Financial management** (to determine whether the SME is creating value and wealth).
- **Managerial accounting** (to determine growth required to be successful).
- **Strategy principles** (to show the owner the way forward that will lead to success and growth).

Following is a short literature review on certain important concepts which are essential for this research. The literature will be used by the researcher to answer the concerns in question. To understand this research, a full understanding is required of a Small to Medium Enterprise.

2.1.1 Defining a Small to Medium-sized Enterprise (SME)

The American Small Business Administration (SBA) classifies a small to medium enterprise business with the criteria that it employs up to 1500 people depending upon the industry sector with annual sales not exceeding \$23 million. Within the EU, since 1996, the small business sector defines a small business enterprise as an organisation employing less than 250 people. A micro-enterprise employs up to 9 individuals and a small business employees between 10 and 49 people. Chaston (2010:5) indicates that “a medium business employs between 50 and 249 people.”

The definition of an entrepreneur can be seen as an individual who “is not that of risk taking, but the willingness to exploit innovation as a path through which to succeed when competing with existing firms.” (Chaston, 2010:7)

According to Chaston (2010:7), the innovation could include a variation of possible actions which may include the following - developing of a new product or service, creating a new production process, identifying new markets or opportunities, discovering new sources of supply and creating new organisational forms.

Thus defining a Small to Medium Enterprise/business is no easy task. According to Megginson, Byrd & Megginson (2006:8), “to be classified as a small business, it must have at least two of the following features”:

- Management is independent, since the manager usually owns the business.
- Capital is given upfront by an individual or a group of individuals.
- Ownership is held by the individual who supplied the capital.
- The area of operations is primary local, although the market may be not.
- The business enterprise is small in comparison with the larger competitors in the industry.
- The strategy of the business is to operate in a niche market.
- The business is very customer orientated. This is the only way to compete against bigger well established businesses.

A very good definition of a Small to Medium Enterprise is indicated by the Congress of the USA in the small business Act of 1953, stating that "a small business is one that is independently owned and operated and is not dominant in its field of operation." (Megginson *et al.*, 2006:8) We also need to distinguish between entrepreneurial ventures and small businesses. The following definitions are given by Megginson *et al.* (2006:9):

A SME is one in which the principle objectives are to be profitable and to grow. Thus the business is characterized by innovative strategic practices and products.

The goals for the SMEs are to make a profit, grow through innovation and strategic management. The primary goal for the SME is to further personal goals, including making a profit. A **small enterprise** can be called a micro-business. This type of business is independently owned and operated, it is not dominant in its field of expertise, and it does not venture off in high cost in terms of research and development. It may never grow large, since the owners prefer it that way. The business is controllable and the owners have control over the SME. According to Megginson *et al.*(2006:8), most of all small businesses are run from home. What is staggering is that these small businesses contribute to more than 60% of the USA's employers and more than \$100 billion in spending. Some small businesses can make unique contributions versus larger competitors. Smaller firms tend to make contributions in the following way:

- Encourage flexibility and innovation.
- Maintain close relationships with customers and the community.
- Keep larger firms competitive.
- Provide employees with a comprehensive learning experience.
- Develop risk takers.
- General new employment.
- Provide greater employee job satisfaction.

To understand why 60% of all business is small to medium in size, it is important to understand why people start small to medium businesses.

2.1.2 The reason why people start SMEs

Today's corporate executives leave the corporate environment to start their own businesses for various reasons. According to Megginson, Byrd & Megginson (2006:15), professionals feel frustrated in the ever changing corporate environment. An uncertain future coupled with long working hours, make employees decide to leave the "rat race" to start their own businesses by implementing the experience gained from the corporate environment. By starting their own businesses, individuals can spend more time with their families, and pursue personal objectives, while achieving the firm's business objectives.

Small to medium enterprises do have difficulties of their own, thus it is not problem free.

2.1.3 Problems associated with SMEs

Problems associated with SMEs vary from business to business. The most common problem as identified by Niewenhuizen & Kroon (2002:24) can be summarised as the following:

- Misuse of funds, constraints of cash-flow, lifeblood of the business.
- Small business finance.
- Impulsive decision making.
- Poor strategy.
- No structure.
- Poor planning for capital expenditure.
- Poor knowledge of proper accounting and managerial accounting principles.
- Human resource management.
- Legal issues.
- Loss of key personnel.

To understand the small business Envirocare, it is important that a short overview be given on what an industry is and what it does.

2.1.4 The Micro Biology industry

The micro biology industry deals with quality control aspects of both the food processing industry and the water purification industry. For all products earmarked for human consumption, strict guidelines are put forth to ensure that these products will not cause harm to humans or animals. One of these guidelines stipulates that certain bacteria should not be present at all in food products and for others limits are set. These specifications are enforced by big retail companies and in certain cases by food specific regulation bodies. For these specifications to be enforced, it is necessary for the enforcing institutions to be 100% sure of the results, as incorrect results can cost a food processing company millions of Rand. Use is therefore made of the SANAS (South African National Accreditation System) accredited laboratories.

Samples of batches of food products are sent to the laboratory on a monthly or weekly basis. These samples are then tested according to approved methods. The micro biology laboratory advises the food processing industry where in their processes there might be contamination of their processed food. It also helps to give an indication as to which raw products are suitable for routine processing and if not, which products need further processing to be suitable for human consumption.

The second and third part of this research will focus on ***managerial-*** and ***financial management*** principles. These principles involve money and cash-flow. Thus an understanding of what money is and what cash-flow is, is essential.

2.1.5 Cash-flow management

Cash-flow is the lifeblood of any business. The SME could be making a profit and still run out of business, by running out of cash. "Money flow around the business and it is important to make sure it keeps flowing as quickly as possible." (Burns, 2007:188)

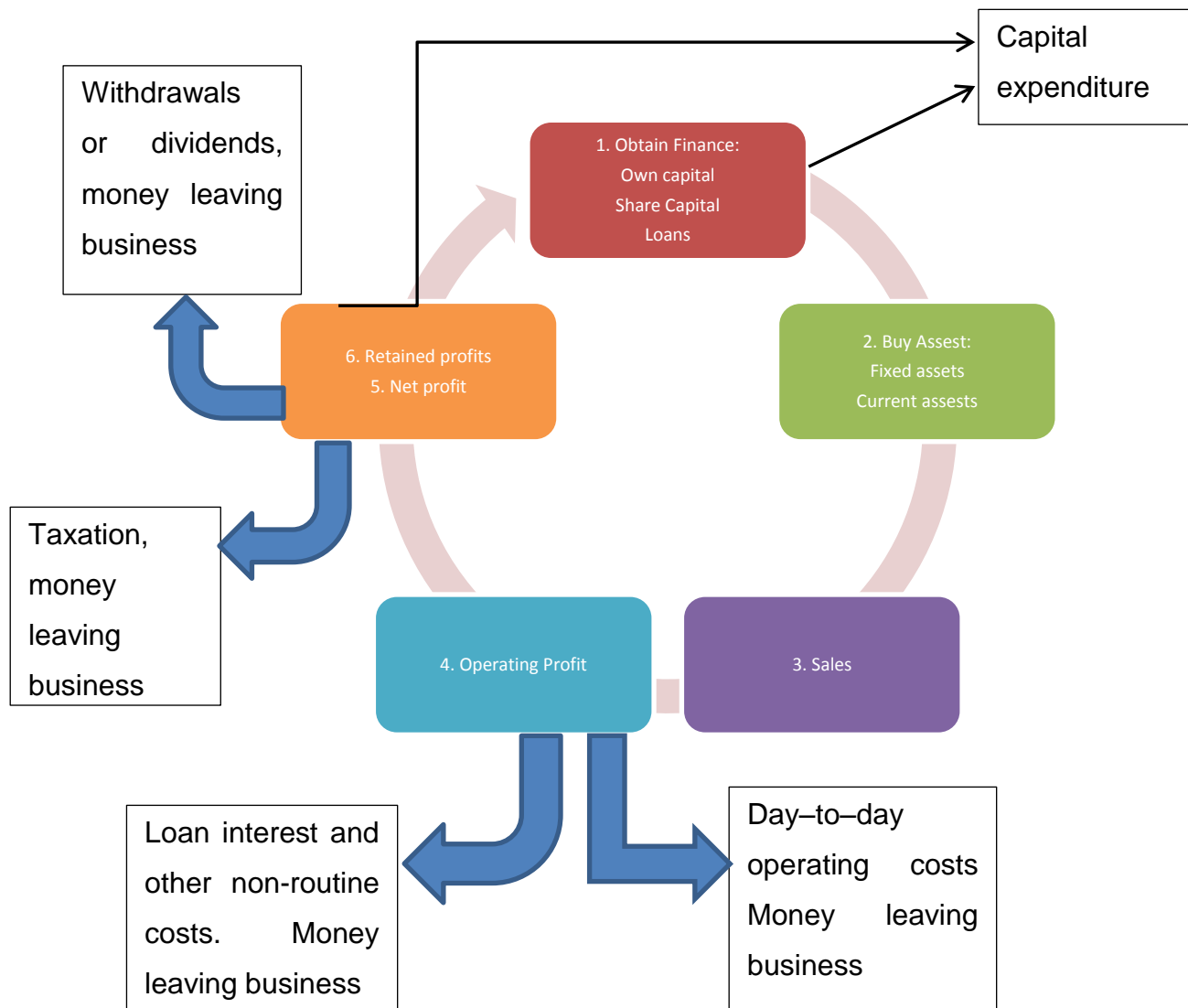
This means that the following processes should run in a chronological order in order to ensure that the working capital or cash available for the SME is always at an optimal level:

- Making sure that debtors pay as quickly as possible.
- Setting credit limits.
- Invoicing promptly.
- Following up furiously on late payments.
- Keeping stock to a minimum (Brau, Brown & Osteryoung, 2004:85).

2.1.6 Defining the flow of money

Working capital of the business in question, which comprises of current assets such as debtors and stock as well as the current liabilities, are tools the owner uses on a daily basis to run the business.

Figure 2.1: The flowing on money (Swart, 2010:81)



1. A business that starts-up, needs to find capital in the form of cash.
2. Money is invested in assets to be used in the business (long-term or fixed assets such as plant or machinery, or office equipment). Current assets will include day to day business assets such as stock, petty cash, and goods for sale, consumables and cash to pay bills.
3. Assets are then used to generate sales. Goods are resold, services are rendered. This is the first stage on the way to making profit.
4. Making sales are not enough to guarantee profit. Sales might be high, but if the day-to-day operations (cost) of the business are higher, a loss rather than a profit will emerge.
5. The result is net-profit. This might still not be money (customers will owe you money or unpaid bills). However, it does represent an increase in the total assets.
6. The balance or retained profit represents another injection of capital into the business.

Value creation for any business big or small starts with ***financial management*** principles.

2.1.7 Financial management principles

Financial management principles will be utilised by studying the financial statements of Envirocare. These principles will clearly indicate whether the SME in question is creating value within the current economic climate or not.

As indicated in Chapter 1, Managerial accounting principles are essential in this research to achieve the primary objective.

2.1.8 Managerial accounting principles

Certain important concepts like, costs-volume-profit and relevant cost, will be utilised to determine whether the opportunity to relocate the micro-laboratory is considered viable. The following concepts need to be identified, according to Stephens (2010:83):

- Current cost of analysis done per month.
- Break-even-point of the company Envirocare.
- Sunken cost to move the laboratory.
- Payback period and amount to replace sunken and laboratory relocation.

A very important shortcoming within SMEs is a clear **strategy** for the organisation. The following part will focus on this concept.

2.1.9 Strategy for SMEs

Any company, whether big or small, should, but not always have a clear path or direction whereby the shareholders can decide or focus their efforts on. SMEs, particularly one man businesses, sometimes lack a clear direction of growth, thus the ability to beat the odds and experience prolonged periods of profitability and growth. The external and internal environment plays a huge role in this regard. The capturing of emerging opportunities, good performance measurement, the adaptation to changing business conditions and the withstanding of competitive challenges from rival firms, all contribute to what is known as a “cleverly crafted and a well-executed strategy (Thompson *et al.*, 2012:51).

The strategy of the organisation, or for the SME in this instance, can be defined as the following according to Moore (2009:277): “the direction and the scope of the organisation over the long-term, which achieve advantages for the organisation, through its configuration of resources within the challenging environment, to meet the needs for its markets and to fulfil the owners’ requirements and expectations”

2.2 CONCEPTS

The concepts of important financial, managerial and strategy principles are described within this section. These concepts will be used extensively within this research. The word **analysis** is defined by the Oxford dictionary as “detailed examination of the elements or structure of something.” Thus, it is a breakdown description of what something really is or can do. To determine value from financial statements, it is important to understand the description of what the financial statements are.

2.2.1 Analysis of financial statements

The financial statement is the “written report of the financial condition of a firm or business.”(Cheatham, 1987:126) An analysis of the income statement, balance sheet and the cash-flow statement will be used to determine important ratios. The use of financial ratios, will help the researcher in determining “the business’s short term liquidity and its ability to make interest and capital payments.” (Megginson *et al.*, 2010:40) The secondary interest would be to determine if the small business is profitable. Thus the researcher will determine if Envirocare is a healthy business and will continue to be successful.

2.2.1.1 Income statement

The income statement is also called the profit and loss statement. The income statement reveals the profit, earnings or margin equals revenue minus expenses.

Burns (2007:168) indicates that it is very important to realise that profit is not the same as cash. Profit is the difference between your sales and your cost or unit selling price and unit cost. It will enlighten the researcher on how the assets of the business has grown or shrunk through trading. It is still possible to make a profit in business but still have no cash available.

2.2.1.2 Balance sheet

According to (Burns, 2007:174), the balance sheet is a snapshot at a particular point of time that reveals two things:

- Where the money is invested in the SME.
- Where the money in the SME comes from.

Brau, Brown & Osteryoung (2004:84) define a balance sheet as “a statement of a company's assets, liabilities, and stockholder equity at a given period of time, such as the end of a quarter or year”. A balance sheet is a record of what a company has and how it has come to have it. A balance sheet is divided into two main sections, one that records assets and one that records liabilities and stockholder equity. The assets should generally equal the liabilities and stockholder equity because the latter two are how the company has paid for its assets.

Money originally comes from the capital the owners invest. In this instance, it is called share capital. It is increased by the profit of the business operating from day to day. Normally, the profit is used to increase the assets of the business. There are different sides of the balance sheets which should always balance. “By definition, the business’s assets must equal the combined value of its liabilities and stock-holders equity.” (Megginson *et al.*, 2010:26)

2.2.1.3 Cash-flow statement

Katz & Green (2006:128) defines the cash-flow statement as “it reports the sources and uses of cash by operating activities, investing activities, financing activities, and certain supplemental information for the period specified in the heading of the statement.” The cash-flow statement is also known as the statement of cash-flows.

The cash-flow statement organizes and reports the cash generated and used in the following categories:

1. Operating activities – Converts the items reported on the income statement from the accrual basis of accounting to cash.
2. Investing activities – Reports the purchase and sale of long-term investments and property, plant and equipment.

- 3. Financing activities – Reports the issuance and repurchase of the company's own bonds and stock and the payment of dividends.
- 4. Supplemental information – Reports the exchange of significant items that did not involve cash and reports the amount of income taxes paid and interest paid.

Here are a few ways in which the statement of cash-flows is used, according to Swart (2010:11):

1. The cash from operating activities is compared to the company's net income. If the cash from operating activities is consistently larger than the net income, the company's net income or earnings are said to be of "high quality". If the cash from operating activities is less than net income, a red flag is raised as to why the reported net income is not turning into cash.
2. Some investors believe that "cash is king". The cash-flow statement identifies the cash that is flowing in and out of the company. If a company is consistently generating more cash than it is using, the company will be able to increase its dividend, buy back some of its stock, reduce debt, or acquire another company. All of these are perceived to be good for stockholder value.

In order to plan for capital expenditure, careful consideration is needed with capital budget decision.

2.2.1.4 Capital budgeting decision

“The goal of capital budgeting is to improve the quality of decisions about how to best use the scarce resources of the business.” (Katz, 2007:501)

Capital budgeting works very effectively by determining the cost benefits of each alternative investment, especially with machinery or real estate. To make such a decision, the concept of time value money is introduced. “The time value of money is the concept that a Rand received today is worth much more than a Rand to be

received in the future. A Rand received today might buy you a Coca Cola, but it might not be enough to buy you a Coca Cola in two years' time" (Katz: 2007:501). The two most common used financial ratios for comparing investment alternatives are:

- Payback period.
- Return on investment (ROI).

The financial management principles are strategic important in determining the current value creation by the organisation.

2.2.2 Financial management principles

In a study done by Kim & Dalbor (2007:440) on the examination of cost management behaviour in small restaurant firms, five different accounting ratios were used to determine the performance of different hospitals, namely return on assets (ROA), return on investment, return on equity, profit margin and operating return and stock return: "They found that both casino and regular hotels with higher managerial ownership had better performance in terms of profit margin, operating return, and return on equity." (Kim *et al.*, 2007:438) The following **profitability ratios** will be of importance to this study:

2.2.2.1 Profitability ratios

- **Return on Assets (ROA)**

Return on total assets, often called "the return on investment (ROI), measures management's overall effectiveness in using the firm's assets to generate returns to common stockholders." (Megginson *et al.*, 2010:46)

- **Return on Equity (ROE)**

The return on equity (ROE) is closely related to the ROA. ROE, which will capture the return earned on the common stockholder (owner) investment in the organization or firm. The important difference being, “for a firm that only uses common stock to finance its operations, the ROE and ROA figures will be identical. With debt or preferred stock on the balance sheet, these ratios will usually differ.” (Megginson *et al.*, 2010:46) Thus it shows the stockholders’ return on their businesses or enterprises. A return of between 12-15% is seen as being average. The trend should always be upward.

- **Profitability**

There are several ways to determine profitability within an organisation. Most companies will use the profitability of the company or organisation as a measure to determine quarterly or yearly bonuses. There are two types of profit margin calculations, namely gross profit margin and net profit margin (Thompson, Peteraf & Gamble, 2012:212).

- **Gross profit margin**

Of the two profit margins mentioned, the gross profit margin (GM) is likely to be the more important of the two. The gross profit margin measures the percentage of each sale in Rand remaining after the organisation or company has paid for its stock/goods. Higher is better and the trend should be upward (Thompson *et al.*, 2012:215).

- **Operating profit margin or return on sales**

The operating profit margin (OPM) measures the percentage of each sale in Rand which remains, after deducting “all costs and expenses other than **interest** and **taxes**.” (Megginson, Smart & Graham, 2007:45) It shows how much profit is earned on each Rand of sales. Thereafter, interest and tax are to be paid. Earnings before

income tax and interest are known as **EBIT**. This variable is widely used to determine the value of a company or business. If the business is an average performer, then EBIT is applied by 4. If the company is an outstanding achiever, EBIT may be applied by 7 or 8. Higher is better and the trend should always be upward (Thompson *et al.*, 2012:216).

Thus, this informs the owners of the company what the bottom line looks like before creditors and the Government's taxes are paid.

- **Net profit margin**

The net profit margin (NP) will measure the percentage of Rand remaining in your business after all costs have been deducted. These costs include interest, taxes and preferred stock dividends. The most observed financial ratio being watched by investors are **Earnings per Share (EPS)**.

It is mentioned by Kim *et al.* (2007:439) that many managers may "attempt to manipulate company earnings or make decisions based upon the compensation structure." Accrual policies chosen by top managers are related to the structure of their compensation packages. It is also noted that managers will tend to manipulate earnings downwards when they have achieved their maximum bonuses. Another way of bending the rules is related to perquisites. This can include company assets for personal enjoyment. Examples may include, fancy office space, hiring of extra staff, or using the company jet plane for personal travel. Other expenses that can be manipulated by management are research and development, advertising, marketing, administrative expenses and marketing expenses.

- **Working capital**

This shows the cash available for a small business's day to day operations. The more cash that is available for day to day expenses, the better. The credit days can be kept to sixty days or less, which in return will earn trust from suppliers. Another

advantage of having enough working capital is that small business owners do not have to lend cash for short term investments. This advantage will include not raising capital from investors. This is according to Megginson *et al.* (2007:88).

- **Return on capital invested**

Shows how effectively a small business can make use of capital invested in the operation, and the return on that investment. Higher is better. The annual trend should be upwards (Thompson *et al.*, 2012:219).

- **Equity security**

Equity is needed to start up a new business. Fortunately, Envirocare started up its business venture in 2007 with very little equity from the owners. The business has grown with no formal debt from any financial institution or equity provided by the owners (Thompson *et al.*, 2012:222).

The following liquidity ratios under financial management need to be reviewed.

2.2.2.2 Liquidity ratios

The following ratios also have a meaningful contribution to small businesses. These ratios should be implemented in this research to make sure that well informed decisions are made (Thompson *et al.*, 2012:223).

- **Current ratio**

The current ratio shows the small business's ability to pay current liabilities using assets that can be converted to cash very quickly. The ratio should be higher than one, but of the two, the higher one is recommended (Thompson *et al.*, 2012:223).

- **Debt-to-asset ratio**

This ratio is very important, since it shows whether the business is in a financially good position. It measures the extent to which borrowed funds have been used to finance business operations. A low ratio or fraction is better. A high fraction or ratio indicates overuse of debt and greater risk of bankruptcy (Thompson *et al.*, 2012:223).

- **Long-term debt-to-capital ratio**

This ratio is an important measurement of the credit-worthiness of the small business. It shows the strength or weakness of the business and gives credibility to the balance sheet. It indicates the percentage of capital investment that has been financed by creditors and bondholders. "A ratio of 0.25 or less is preferred. This indicates that most of the capital invested was by the business owners. The lower the ratio, the better is the capacity to borrow additional funds for the business. A ratio of 0.5 or higher indicates a heavy or excessive reliance on debt. This leads to lower credit-worthiness and a weak balance sheet." (Megginson, Smart & Graham, 2007:98)

- **Debt-to-equity ratio**

The debt-equity ratio should usually be less than one. A high ratio, which is normally higher than one, signals excessive debt, lower credit-worthiness, and weaker balance sheet strength. How can a business owner improve on the debt-equity ratio? According to the Harvard Business Review (1981:32), owner managers can better their debt-equity ratio by improving their earnings, thus earnings will definitely help, but to increase earnings, you need to grow in sales, and that takes time. The easiest

way to do this is to increase the profit margin. Other ways to improve debt-equity ratio may include reducing expenses, improving on productivity, reducing unit cost and increasing sales price. Other possibilities are tightening sales terms or changing debtors' days from 30 days to 10 days. Small business owners can be severely constrained by poor discipline within these areas. This may lead to a volatile competitive environment. "Liquidity must be a prime objective. The analytical models applicable to big businesses are of limited use in this arena." (Harvard Business Review, 1981:32) The small business owner cannot afford professional advice. Therefore, is it essential that the small business owner needs to be logical in the thinking process, which can include switching roles, from debtors clerk to salesperson and back to financial advisor. Where big businesses are moving towards more sophisticated models, the attempt of the small business owner should be back to basics.

- **Long-term debt-to-equity ratio**

This ratio shows the balance between debt and equity in the business's long-term capital structure. A lower ratio indicates that the business can borrow more long-term funds (Thompson *et al.*, 2012:224).

- **Times-interest earned or coverage ratio**

It measures the ability to pay off annual interest charges. Lenders and banks usually insist on a minimum ratio of two or more. A ratio above three signals will better credit-worthiness (Thompson *et al.*, 2012:224).

The following activity ratios under financial management need to be reviewed.

2.2.2.3 Activity ratios

Activity ratios indicate how a business is running – how well the stock is managed, how well money from debtors is collected. The total supply chain's effectiveness can be monitored by using activity ratios (Thompson *et al.*, 2012:224).

- **Days of inventory**

This ratio measures inventory management. Thus how quickly stock, which is part of working capital, can be moved out and converted into cash – the higher stock turnover, the better; the lower the days of inventory, the better for the business cash-flow (Thompson *et al.*, 2012:224).

- **Inventory turnover**

Inventory turnover is just the opposite of days of inventory. Where the business wants less days of inventory in the stores, the business wants as high as possible inventory turnover per year (Thompson *et al.*, 2012:226).

- **Average collection period**

This ratio indicates the average length of time the business must wait before their cash is collected - the shorter the collection period, the better (Thompson *et al.*, 2012:226).

2.2.2.4 Other important financial ratios

There are various other important ratios, however, for our research one ratio can be seen as important in this study.

- **Internal cash-flow**

It is a quick and rough estimate of the cash a small business is generating after payment of operating expenses, interest, taxes, dividends and reinvestments of the small business. The larger the sum of the free cash-flow, the greater the ability of the company to internally fund new ventures, repay long and short term debt, make new acquisitions, repurchase shares and stock options or increase dividend pay-outs. (Thompson *et al.*, 2012:227).

2.2.3 Managerial accounting principles

Certain managerial accounting principles applicable for this research are explained below:

2.2.3.1 Relevant cost principles

Relevant cost principles will show the researcher whether:

- The move to relocate will be a wise decision.
- What prices to charge for the analyses done.
- What channels of distribution to choose.

The cost whether to stay at the current location or to move to the new premises will be determined by relevant cost principles. Thus data that is relevant to the research will be determined and extracted from data which is irrelevant.

2.2.3.2 Cost behaviour

“Cost behaviour is the way in which a cost reacts or responds to changes in the level of business activity.” (Stephens, 2010:82) The following concepts are discussed within cost behaviour.

- **Cost-volume-profit (CVP) analysis**

“CVP analysis is a powerful tool that helps managers understand the relationships among cost, volume and profit. CVP analysis focuses on how profit is affected by the following five factors.” (Garrison, Noreen & Brewer, 2008:233)

- Selling price.
- Sales volume.
- Unit variable cost.
- Total fixed cost.
- Mix of products sold.

Thus, it is clear that CVP analysis can help managers to make informed decisions. It can also reveal how profit is affected by these factors. It is a vital tool in many business decisions, which can include the following:

- What selling price to ask?
- What marketing strategy to follow?
- What kind of services to offer?

“The cost-volume-profit analysis is the systematic examination of the relationships between selling price, sales, production volumes, costs, expenses and profit. This analysis provides very useful information of decision-making in the management of any small company.” (Reilly, 2009:30) The analysis can be used in establishing sales, price and impact on profit, by changing in costs. In the current environment of business, a business owner must act and take decisions in a fast and accurate manner. As a result, the importance of cost-volume-profit is still increasing.

- **Variable cost**

“The variable cost and price are stated, as per unit cost. The price of each product does change with the level of sales, such as the cost of goods sold.” (Kim & Dalbor, 2007:444) The price of the product has been set by the company by looking at the wholesale cost of the product, or the cost of manufacturing the product, and the making of it.

- **Fixed cost**

“Fixed cost, are those costs that do not change with the levels of sales, such as overheads. In this formula, fixed cost is stated as a total. This is the fixed cost of the business.” (Kim & Dalbor, 2007:445)

- **Break-even-point analysis**

According to Reilly (2009:29), the break-even analysis can be a simple yet powerful tool to help small business owners and enterprises to manage their business. The break-even analysis has first been used in accounting journals as far back as 1850.

In the 19th century the Interstate Commerce Commission used the break-even analysis with great success in determining the adequacy of railroad-freight rates. As its name indicates, the break-even analysis calculates the unit of Rand sales needed in a business to generate enough revenue, that will exactly match the fixed and variable cost to produce a net profit of exactly zero. Thus a business's break-even-point is the point at which its sales exactly cover its expenses. The business sells enough units of product to cover its expenses without making a profit or taking a loss. If it sells more, it is making a profit; on the other hand, if it sells less, it takes a loss.

It is of cardinal importance to be certain to allocate fixed cost and variable cost to the right buckets. The advantage of break-even-point analysis is its simplicity and user friendly approach. According to Reilly (2009:29), there are several potential weaknesses of the break-even analysis that should be pointed out:

- Unlike discounted cash-flow techniques, such as Net Present value, Internal Rate of Return, which examines cash-flow over a period of time, break-even analysis provides a ***static viewpoint*** based on a single point of time.
- The break-even analysis assumes a fixed relationship between price, cost and volume at every level of the production process. Thus economy of scale and the reduction of unit price per unit as volume increases, do not apply. At lower levels of sale, unit cost will increase and cost will rise proportionally. It is therefore recommended by Reilly (2009:30) that the break-even analysis should be adjusted upward or downward appropriately for the assumed production levels.
- It is also suggested that the break-even analysis is not easily applied to a multi-product business with different prices and costs, associated with the different products. A certain product mix should be used, with a corresponding weighted average price.
- "The break-even model assumes that every unit produced is sold at the same price without regard to limitations of market demand and competition." (Reilly, 2009:30)

A very valuable use for the break-even analysis is to determine and compare the existing break-even analysis of existing products as a bench-mark. By doing this, the

owner or franchisor could possibly identify poorly performing products and those who are exceeding expectations. In conclusion, although the break-even analysis cannot be used in isolation to make important decisions, it can provide the owner/franchisor of a small business information to screen new opportunities, evaluate competitive information and streamline current operations.

2.2.3.3 Payback period

The period of time it takes a business to earn back the funds it has paid out to obtain a capital interest. The payback period measure is a statement of how much time must pass before your business receives back the same amount of Rand in cash-flow as paid out to obtain a capital asset. Only accept two rules for this measurement (Megginson, Smart & Graham, 2007:102):

1. Accept only those alternatives for which time required to recoup the original investment is equal to or less than a maximum allowable time determined by management.
2. Accept the alternative with the shortest payback period among those that meet the first criteria.

2.2.4 Strategy principles

The word strategy means “**militarium**” in Latin and indicates what kind of move the Roman Empire forces (military) would make to ensure victory of its enemy on the battlefield. In the same manner, the SME must make strategic moves in the business environment to ensure growth (Thompson, Peteraf, Gamble & Strickland, 2012:53). A strategy is about competing on a different level as its rivals. It is doing what competitors cannot do, doing it better or doing what competitors do not do. To have a sustainable competitive advantage, the SME must attract customers, through needs, more effectively, efficiently and different from rivals. In the same manner, it must be able to retain these customers. This research will focus on the following aspects within the field of strategy,

2.2.4.1 Strategic vision

According to Thompson *et al.* (2012:71), “a strategic vision describes management’s **aspirations** for the future and delineates the company’s strategic course and long-term direction.” Thus the vision of the company is to show or indicates the direction.

2.2.4.2 Strategic mission

“The mission indicates and describes that the current state, **direction**, **purpose** of the business. Thus this direction and purpose should be conveyed in language and should be specific enough to give the SME its own feeling and identity.” (Thompson *et al.*, 2012:73)

2.2.4.3 Strategic core values

The values of the SME are the “beliefs, traits, and the behavioural norms that management has determined should guide the pursuit of its vision and mission.” (Thompson *et al.*, 2012:75)

2.2.4.4 Strategy with SWOT analysis

“The strengths, weaknesses, opportunities and threats analysis is one tool that is used in strategy to determine the way forward. The pay-off from **SWOT- analysis** comes from the conclusions about the SMEs situation and the implications for strategy improvement that flow from the analysis.” (Thompson *et al.*, 2012:89)

2.2.4.5 Strategy with Porter’s five forces

The character as well as the strength of any business has forces that compete and operate in each industry. These forces never stay the same, but continuously change in the business environment. The most effective and most recognised tool for systematically diagnosing the principle competitive pressures in the market is the **Five-Forces Model of Competition**. “This model holds that the competitive forces affecting industry profitability go beyond rivalry among competing sellers and include pressures stemming from four coexisting sources.” (Thompson *et al.*, 2012:102)

These forces include the following,

- “Competitive pressures stemming from supplier bargaining power,”
- “Competitive pressures coming from the producers of substitute products,”
- “Competitive pressures stemming from buyer bargaining power,”
- “Competitive pressures coming from the threat of entry of new rivals,”
- “Competitive pressures coming from other firms in the industry.” (Thompson *et al.*, 2012:102)

2.3 SUMMARY

It is very different to manage a small company effectively than running a big corporate institution. Thus small business owners must have a very different outlook and must apply different principles than those ordinary used by big companies. According to Welsch & White (1981:18), there are the notion to run small companies exactly like bigger companies, only with smaller sales, smaller assets and fewer employees. However, smaller businesses are exposed to “**resource poverty**” that differentiates them from bigger business units. Resource poverty results from various unique conditions which are only applicable to smaller businesses. Any price cutting exercise within a small business destroys profit to an extent that it can put the small business in jeopardy. Big businesses can afford to give huge discounts in either retail or wholesale, spend huge amounts of money on Research and Development, and marketing and implement price cuts as part of strategy to gain market share.

All of this implies that a small business can seldom make huge mistakes and recover from them. Thus small companies cannot carry huge financial blunders, while repairing the problem. Profitable **slow** growth over an extended period of time is the golden rule for small companies to survive difficult economic circumstances.

In big businesses, the rate of change on annual growth is normally small. Thus their financial results show a company in equilibrium. For example, 10% growth over R10 million is R1 million, thus a small growth rate over a significant amount is huge.

Small businesses are seldom in equilibrium. One customer paying late, or a late delivery, or a supplier going bankrupt, throws the small business into turmoil and uncertainty. In addition, small businesses are much more exposed to seasonal variation, which indicate waves of fast end then slow growth. Owners of small businesses are also prone to spend too much cash in the growth season, leaving very little liquidity during slow growth seasons. This causes financial institutions to be very uncomfortable. Large amounts of stock coupled with long debtor days and discount rates can cripple a small business quickly.

To summarise everything, the following: a small business can sustain a surprisingly long time without a profit. The day it fails to make a critical payment, is the day it folds. **Cash-flow** is the single most important factor within the small business enterprise. It is more important “than the magnitude of the profit or the ROI”. “Liquidity is a matter of life and death for the small business.” (Welsch *et al.*, 1981:29) Salaries must be paid weekly or biweekly to ensure enough cash-flow. Thus for the small business owner, profit is not cash and profit plus depreciation is not the available cash-flow. Thus, the small business owner seldom has stable operations from which to launch a new endeavour. Typically, a new endeavour can, and most times will, threaten the existence of the basic business. Thus before moving to a new the premises, the small business owner must carefully examine cash-flow, and must visualize the future operations to a great deal. In addition, acquiring much needed cash when the business is in a growth phase is extremely difficult. The business’s worth will be much lower than what the income statement, cash-flow statement and balance sheet indicates. It is imperative that careful consideration should take place before a new venture is undertaken.

2.4 CONCLUSION TO THE CHAPTER

Important financial, managerial and strategy concepts are explained which are all vital to grow in any small to medium business. These principles, as explained, are the universal language by which managers can determine and sustain profitability within business units, from large corporations to small enterprises.

CHAPTER 3

EMPIRICAL STUDY

3.1 INTRODUCTION

Empirical research is a way of gathering information or knowledge by means of direct and indirect observation or experience. For this research, information has been gathered by direct interview as well as the interpretation of financial statements. As indicated in Chapter 1, the researcher has interviewed the owner of the micro-laboratory business called Envirocare.

3.2 GATHERING OF DATA

A qualitative research approach has been followed by way of interviews, observation and the analyzing of the financial statements. The objectives were:

- To define a small to medium based enterprise (SME).
- To determine why people start small to medium businesses.
- To determine problems associated with small to medium businesses (SMEs)
- To understand the Micro Biology industry.
- To define cash-flow management.
- To understand the flow of money and how it is managed.
- To implement financial management principles in Envirocare.
- To implement managerial accounting principles in Envirocare.
- To determine the strategy of SMEs and of Envirocare.

Following is a summary of the financial ratios calculated by utilizing the financial statements, ending February 2011 and 2012.

3.3 FINANCIAL MANAGEMENT RATIOS INTERPRETATION

Part 3.3 will be an in-depth interpretation of the financial ratios done. As explained in Chapter 2, different ratios will be applied. The following profitability-, liquidity-, leverage-, activity and other important ratios are utilized and the results explained.

3.3.1 Profitability ratios (Table 3.1):

The ratios below were determined by using the financial statements of Envirocare from year end 2011 and year end 2012.

Profatibility Ratios						
		Year	Year			
		2011	2012			
Ratio	Gross profit margin	58.00%	57.61%			
	Operating profit margin (EBIT)	2.70%	6.39%			
	Net profit margin	2.73%	6.39%			
	Return on Total Assets	12.43%	36.41%			
	Return on Stockholders equity	22.31%	40.65%			
	Return on invested capital	9.94%	38.72%			

3.3.1.1 Gross profit margin

The Gross Profit margin of 58% and 57% respectively for the financial years ending 2011 and 2012 is good, but not outstanding. It must be emphasized that the SME is not selling goods, but a service. Service in general has no fixed value but is determined by market forces. However, good service can warrant a premium and therefore the micro-laboratory should try to increase the annual Gross Profit margin percentage by means of differentiation.

3.3.1.2 Operating profit margin (EBIT) & Net profit margin

These margins are quite low at 2.7% and 6.39% for 2011 and 2012 respectively. The trend is extended for Net Profit margin. Normally a band of between 5-15% is preferred. The owner of the SME has indicated that there is no long-term debt; therefore all fixed and variable expenses are covered. However, a higher EBIT and NP are recommended. The trend should be upward and higher is better.

3.3.1.3 Return on total assets (ROA), Stockholders equity (ROE) & Invested capital

An average return on these ratios would indicate 12% to 15%. For 2011, these percentages were average, indicating a good solid return on investment. The results for 2012 are excellent and the trend should be continued. The owner of the SME indicated that all available funds are ploughed back into the business. No additional bonuses or director fees have been paid out other than the normal 13th pay check. The return is thus clearly evident and worthwhile. Total Asset return was 12.43% for 2011 and a very good return of 36.41% in 2012. The return on stock- holder's equity showed even better results moving up from 22.31% in 2011 to 40.65% in 2012. The return on invested capital moved from 9.94% in 2011 to a fantastic 38.72% in 2012.

3.3.2 Liquidity ratios (Table 3.2):

The ratios below were determined by using the financial statements of Envirocare from year end 2011 and year end 2012.

Liquidity Ratios						
Ratio		Year	Year			
		2011	212			
	Current Ratio	21.27	12.95			
	Working capital	R 221 471	R 166 658			

3.3.2.1 Current ratios & Working capital

The current ratio should be 1 to indicate that this SME can pay its current liabilities using assets that can be converted in the near term. Envirocare showed an excellent

21.27 ratio for 2011 which dropped to 12.95 for 2012. The ratio for 2011 clearly indicated that funds were readily available to relocate the premises from its current location at the North-West University to the new premises in the central business district of Potchefstroom. The funds needed for the relocation were extracted from its current assets, thus resulting in the ratio drop to 12.95 for 2012.

The working capital for such a small enterprise looks excellent which indicates a healthy scenario for day to day operations. Creditors are paid on time and it seems unlikely that this SME will need to borrow funds from financial institutions in the near future.

3.3.3 Leverage ratios (Table 3.3):

The ratios below have been determined by using the financial statements of Envirocare from year end 2011 and year end 2012.

Leverage Ratios					
Ratio		Year	Year		
		2011	2012		
	Debt -to- asset ratio	0.57	0.11		
	Long-term debt-to-capital ratio	0.55	0.04		
	Debt -to- equity ratio	0.57	0.11		
	Long-term debt-to-equity ratio	1.34	0.12		

3.3.3.1 Debt-to-asset-ratio & Long-term debt-to-capital ratio

These ratios measure the extent to which borrowed funds have been used to finance the firms operations. By examining the SMEs results for 2011, which indicate 0.57 and an even better ratio of 0.11 for 2012, it has been determined that the SME has reduced its risk of overusing of debt and a greater risk of bankruptcy.

The credit-worthiness of the SME in question has improved vastly from 2011 to 2012. The long-term debt-to-capital ratio indicates the percentage of capital investment that has been financed by creditors (banks & bond holders). A ratio of below 0.25 is usually preferable, since cash invested by the owner's account normally is 75% or

more of the SMEs total capital. The lower the ratio, the better it is for the business in question. This means that the laboratory can borrow additional funds in the future. Observing the results for Envirocare, 2011 indicate an average ratio of 0.55 and an excellent ratio result of 0.04 for 2012. This result indicates that Envirocare shows a low reliance on debt, is highly credit-worthy and shows a strong balance sheet.

3.3.3.2 Debt-to-equity ratio

The debt-equity ratio shows an excellent 0.57 and 0.11 for 2011 and 2012 respectively for Envirocare. Thus the ratios indicated that the SME in question does not have excessive debt, a weak balance sheet or low credit-worthiness. The ratios indicate excellent credit-worthiness, low debt and a strong balance sheet. The balance between debt and equity in Envirocare shows a fantastic balance between debt and equity.

3.3.3.3 Long-term debt-to-equity ratio

The long-term capital structure is very healthy. Ratios for 2011 and 2012 were 1.34 and 0.12 respectively. This sharp decline indicates that for the period 2011-2012 a sharp increase of growth has occurred whereby Envirocare could pay off its creditors and possible debt. The funds that were ploughed back into the organisation show that Envirocare has an excellent capacity to borrow additional funds if needed.

3.3.4 Activity ratios (Table 3.4):

The ratios below have been determined by using the financial statements of Envirocare from year end 2011 and year end 2012.

Activity Ratios						
Ratio		Year				
		2011	2012			
	Days of inventory	N/A	N/A	Product is not sold but service		
	Inventory turnover	N/A	N/A			
	Average collection period	69.17	42.78	days		
	Average daily sales	R 2 580.67	R 3 387.86			

3.3.4.1 Days of inventory & Inventory turnover

These ratios could not be determined since Envirocare as a business does not buy and re-sell product. The business buys product and use the product to create results. These results are then sold as a service to customers. The price of the results in this instance (analysis) is determined by the market. The service provided to customers can carry a premium and in this instance it does, since Envirocare focuses on satisfying individual customer needs. In addition, Envirocare does analyses over weekends which no other laboratory does. The business has therefore created a niche market in which it operates.

3.3.4.2 Average collection period

Average collection period has gone down from 69 days to 42 days in 2011 to 2012 respectively. This reduction in debtors is clearly evident in the profitability, liquidity and leverage ratios. Average debtors within the industry are between 55 and 60 days. Envirocare has indicated that for 2012 a greater emphasis has been placed in reducing debtors and bad debt.

3.3.4.3 Average daily sales

The average daily sales are an indication of what the business is generating in sales per day. For 2011, the average sales were R2 580.67 and for 2012 it was R3 387.86. This is an increase of 31% over the last 12 months.

3.3.5 Other ratios (Table 3.5):

The ratios below were determined by using the financial statements of Envirocare from year end 2011 and year end 2012.

Other Ratios						
Ratio		Year	Year			
		2011	2012			
	Internal Cash flow	R 115 288	R 194 316			
	Free cash flow (FCF)	R 115 288	R 194 316			

3.3.5.1 Internal cash-flow & free cash-flow (FCF)

This is a quick and roughly estimation of what Envirocare is generating after payment of operating expenses, taxes and interest. This amount normally is used for dividend payments or funding or capital expenditure. The internal cash-flow from Envirocare has increased from R115 288 in 2011 to R194 316 in 2012. This is an increase of 65.55% from 2011 to 2012, showing excellent growth in internal and free cash-flow over the last 12 months.

The free cash-flow is exactly the same as the internal cash-flow for Envirocare and indicates that the cash Envirocare is generating after payment of operating expenses, interest and taxes. All available money should be re-investment in the business (which Envirocare has done). The larger the free cash-flow of the business, the better it is for the company to internally fund new strategy initiatives. In this instance, the decision to relocate its facilities to the central business district is certainly approved. The total cost to relocate and refurbish the laboratory seems a done deal. The total amount of **R146 413.38** can be carried by the business and no additional funding is necessary from banks or institutions.

The following managerial accounting principles were applied.

3.4 MANAGERIAL ACCOUNTING PRINCIPLES INTERPRETATION

A list of sunken costs has been obtained by the owner. Table 3.6 indicates the renovations to be executed in order to make the new laboratory presentable.

3.4.1 Capital expenditure to relocate laboratory (Table 3.6):

BUILDING CHANGES	COST ONCE-OFF
Tiling	R 4 468.95
Labour	R 1 785.00
Additional water piping	R10 970.00
Metal Frames	R 2 000.00
Cupboards	R 3 450.00

Working area	R 2 425.46
Gas	R 2 500.00
Small basin	R 760.00
Gas geyser	R 5 500.00
Computers	R10 000.00
Desk	R 1 600.00
Chairs	R 1 900.00
Laboratory chairs	R 1 500.00
Big basin	R 1 426.00
Ad hoc	R 2 500.00
Total	R52 785.41

Equipment needed for new laboratory (Table 3.7):

New equipment is needed for Envirocare to meet the increasing demand from customers. In addition, the new equipment will be used to pay back the money spent (to relocate the business) over a three year period.

EQUIPMENT	ONCE-OFF COST
Water dispenser	R 1255.00
Autoclave (2 nd hand from NWU)	R 2000.00
Glass ware (Glass world)	R 4 353.00
Glass ware (Lasec)	R 3 231.97
Vacuum pump	R 3 980.00
RO system	R 3 400.00
Fridge	R 9 190.00
Transport of fridge	R 700.00
Analytical balance	R12 000.00
Telephone & network (ADSL)	R 1 450.00
Trolley	R 3 808.00
Stirrer hotplate	R 3 680.00

Accreditation cost (SANAS)	R26 580.00
Calibration cost	R15 500.00
Ad hoc costs	R 2 500.00
Total	R93 627.97

The cost to relocate the micro-laboratory to the new premises and to change the current location into a micro-laboratory, estimates to **R146 423.83 (R 52 785.41 + R 93 627.97)** in total. To pay back this amount over a period of three years, including a fixed interest rate of 6% (compounded) will be **R4 843.80** per month. Taking into account the results obtained from the ratios previously, it is more than likely that the owner of the micro-laboratory will go ahead with the planned relocation of the laboratory.

Monthly cost increase (Table 3.8):

The personal assistant will be required to work an additional two hours per day. The additional expense mounts to R1 500 per month.

Salary increase p/m	R1 500.00
Electricity	R1 450.00

Payback (Table 3.9):

To pay back the R146 423.83 for relocating the micro-laboratory as well extra equipment needed, the micro-laboratory will need to pay back R174 380.67 over a period of three years.

Payback is R146 413.38

Year one with 6% interest	R 155 198.18
---------------------------	--------------

Year two 6%	R 164 510.00
Year three 6%	R 174 380.67

Thus an additional growth of R4 843.90 per month is needed to pay back the relocating cost and new equipment.

Additional growth required within the next 36 months = R4 843.90

3.4.2 Relevant cost

The only relevant cost applicable for Envirocare is sunken costs. As discussed under Free Cash-Flow, the laboratory had to make a decision whether to move the laboratory from its current location to the new premises. These costs, as illustrated, are once-off costs and there are sunken costs. Make or buy decision as well as opportunity cost were not applicable to Envirocare, since the laboratory had no other choice than to relocate due to higher demand from customers.

3.4.3 Cost-volume-profit analysis (Table 3.10):

	Types of tests done in Envirocare Micro laboratory				
Type analysis	Quantity done	Cost price p/unit	Total Cost Price	Selling price p/unit	Total Selling Price
WATER ANALYSIS					
Water Analysis (Type 1 involves 4x different tests	180	R 19.50	R 3 510.00	R 212.00	R 38 160.00
Water Analysis (Type 2 involves 3x different tests	87	R 12.10	R 1 052.70	R 193.00	R 16 791.00
TOTAL	267	R 31.60	R 4 562.70	R 405.00	R 54 951.00
FOOD ANALYSIS					
Total plate count	92	R 4.70	R 432.40	R 58.90	R 5 418.80
Total Coliforms	88	R 17.00	R 1 496.00	R 47.10	R 4 144.80
E. Coli	88	R 17.00	R 1 496.00	R 45.10	R 3 968.80
Staphylococcus	62	R 34.32	R 2 127.84	R 105.00	R 6 510.00
Salmonella	60	R 13.00	R 780.00	R 105.00	R 6 300.00
Clostridium	4	R 130.00	R 520.00	R 101.65	R 406.60
Pseudomonas	22	R 11.00	R 242.00	R 58.90	R 1 295.80
Listeria	9	R 51.37	R 462.33	R 153.00	R 1 377.00
Campylobacter	9	R 9.60	R 86.40	R 417.30	R 3 755.70
Bacillus cereus	45	R 30.00	R 1 350.00	R 99.00	R 4 455.00
Enterobacteriaceae	6	R 15.10	R 90.60	R 48.15	R 288.90
TOTAL	485	R 333.09	R 9 083.57	R 1 239.10	R 37 921.40
EGG ANALYSIS					
Total plate count	18	R 4.14	R 74.52	R 42.80	R 770.40
Total Coliforms + E. Coli	18	R 17.00	R 306.00	R 42.80	R 770.40
Staphylococcus	18	R 34.32	R 617.76	R 64.20	R 1 155.60
Yeast + Mold	18	R 22.00	R 396.00	R 48.15	R 866.70
TOTAL	72	R 77.46	R 1 394.28	R 197.95	R 3 563.10
SWAB ANALYSIS					
3 IN 1	32	R 29.00	R 928.00	R 82.40	R 2 636.80
EQUIPMENT SWAB	180	R 2.00	R 360.00	R 47.10	R 8 478.00
Listeria	15	R 12.00	R 180.00	R 47.10	R 706.50
Contact slides	55	R 1.00	R 55.00	R 32.10	R 1 765.50
TOTAL	282	R 44.00	R 1 523.00	R 208.70	R 13 586.80
OTHER					
Cholera	10	R 20.00	R 200.00	R 240.00	R 2 400.00
Uranium	28	R 324.00	R 9 072.00	R 375.00	R 10 500.00
Chemical	9	R 606.00	R 5 454.00	R 813.00	R 7 317.00
Antibiotics	10	R 44.00	R 440.00	R 390.00	R 3 900.00
TOTAL	57	R 994.00	R 15 166.00	R 1 818.00	R 24 117.00
COST TO RELOCATE LABORATORY / 36 MONTHS			R 4 843.90		
	average cost p/unit				
GRAND TOTAL	1163	R 1 480.15	R 36 573.45	R 3 868.75	R 134 139.30

By analysing the financial statements as well as information obtained by the owner of the business, the following calculations have been derived:

- Total average sales per month = **R134 139.30**
- Total average fixed cost per month= **R14 781.83**
- Total average variable cost per month = **R80 674.17**
- Average selling price per unit = **R115.34**
- Grand Total units analysed = **1163**
- Contribution Margin = **40%**
- Net operating income per month = **R38 683.00**
- Break-even-point calculated = **321** analysis

Expenses from income statement (Table 3.11):

This table shows the expenses for Envirocare per annum as well as per month. Total fixed cost per month calculated to R14 781.83 and the variable cost per month calculated to R80 674.17.

EXPENSES FROM INCOME STATEMENT ENDING 29 FEBRUARY 2012			
FIXED COST		R 177 382.00	R 14 781.83
VARIABLE COST			
	STOCK	R 519 039.00	R 43 253.25
	BANK CHARGES	R 6 273.00	R 522.75
	OWNER COMPENSATION	R 391 001.00	R 32 583.42
	VEHICLE COST	R 25 178.00	R 2 098.17
	ENTERTAINMENT	R 5 107.00	R 425.58
	ACCOUNTANT FEES	R 8 000.00	R 666.67
	INTEREST	R 377.00	R 31.42
	MAINTENANCE	R 800.00	R 66.67
	TELEPHONE & OFFICE EXP.	R 12 315.00	R 1 026.25
VARIABLE	TOTAL MONTH		R 80 674.17
VARIABLE + FIXED	TOTAL MONTH		R 95 456.00

By using the variables as indicated in table 3.10, it was possible to calculate the following:

- Total analysis selling price.
- Selling price per unit.
- Total analysis cost price.
- Cost price per unit.

Average selling price per unit (Table 3.12):

By utilising the above mentioned information, the total amounts of units have been determined. In addition, the variable expenses in GM percentage has been determined as well as the Contribution margin percentage.

UNITS	AVERAGE SELLING PRICE/ UNIT	TOTAL SALE	
1163	R 115.34	R 134 139.30	
	Total	Per unit	
Sales (1163 analysis)	R 134 139	R 115	
Variable expenses	R 80 674	R 69	60%
CM	R 53 465	R 45.97	40%
Fixed expenses	R 14 782		
Nett Operating Income	R 38 683		

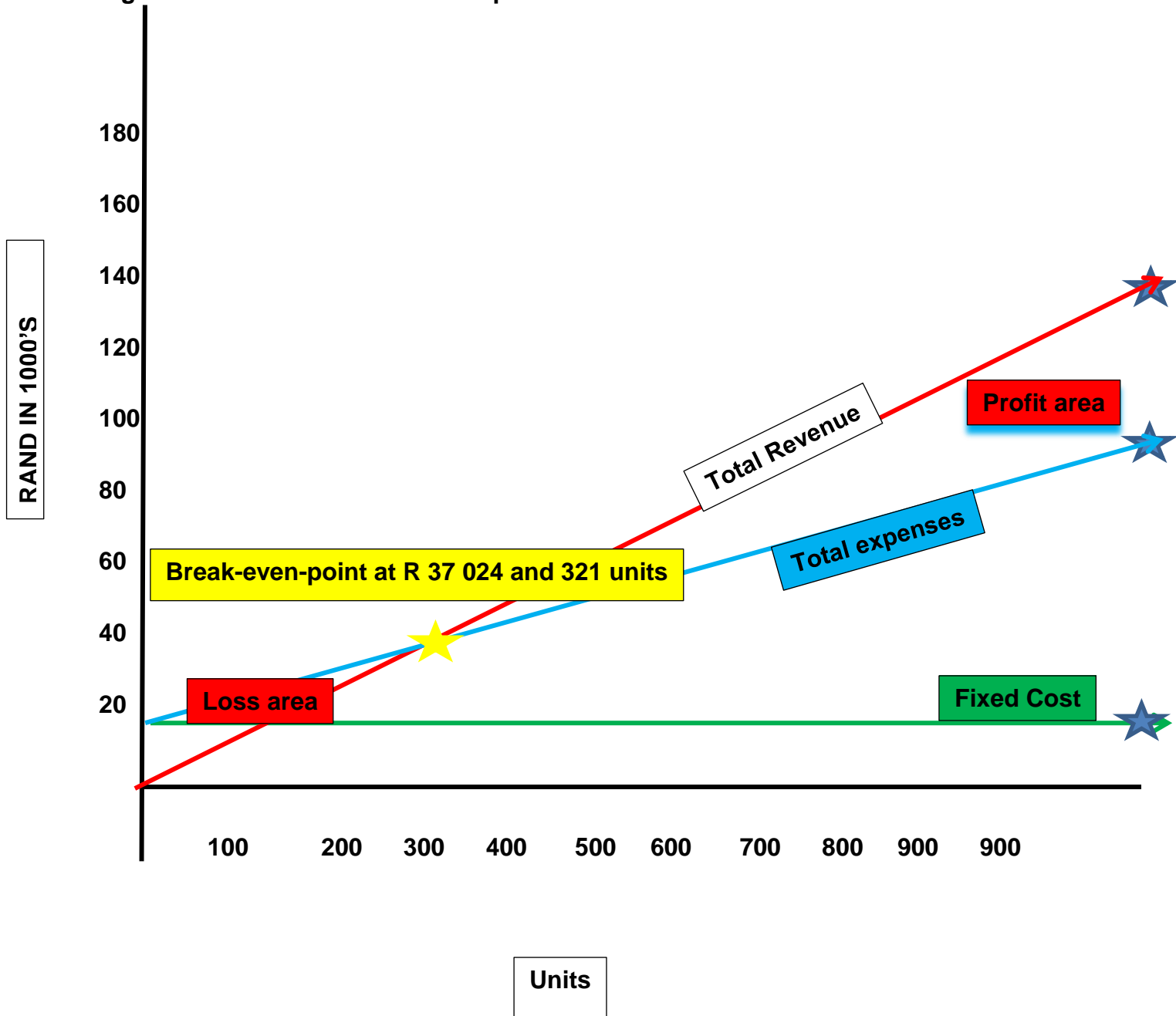
Once the total sales were known as well as the variable expenses, contribution margin, fixed expenses and the net operating income, the break-even-point has been calculated.

Break-even point calculation (Table 3.13):

	BREAK-EVEN POINT CALCULATED		
321	R 37 024	115	
Variable expenses	R 22 242	69	60%
CM	R 14 782	46	40%
Fixed expenses	R 14 782		
	R 0		
Break-Even Computation:			
Equation Method:			
Profits=(sales-Variable expenses)-Fixed expenses			
Sales=Variable Expenses + Fixed Expenses + Profits			
115Q=69Q+R14 782 + 0			
46Q=14 782			
Q=321			
	Test	115(321)-69(321)-14782=0	
		0	
	0	0	
		14782	
		-14782	

The determination of the break-even-point has been made more difficult by the fact that Envirocare has more than one different analysis and more than one price for the different analyses. To determine the break-even-point, the researcher had to determine the total amount of analyses done per month per working schedule. The total cost of the analyses have been determined as well as the total average sales per month. By calculating the average fixed cost and variable cost per month the researcher has been able to determine the break-even-point at 321 analyses per month as per schedule. **FIGURE 3:** (indicating break-even-point of Envirocare laboratories at **R37 024**), show that the “relationships among revenue, cost, profit and volume can be illustrated on a **cost–volume–profit (CVP) graph**.” The CVP graph highlights CVP relationships over a wide range of activities.

Figure 3: Indicate the break-even-point for Envirocare Laboratories



The following part consists of the strategy of Envirocare. This section includes the strategy principles as discussed in Chapters 1 & 2.

3.5 CURRENT STRATEGY

An interview with the owner of the business revealed that there is no official strategy for the business. The owner has indicated that the business is very customer driven and that new business came from “word of mouth” references. The owner indicated that the business has changed its scope of work to be customer driven by:

- Doing analyses over weekends as well.
- Providing results within 48 hours of samples taken.
- Implementing additional methods of analysis as requested by the most valid customers.
- Doing all analyses and results through the SANAS (17025)* accreditation methods and standards.

***= SANAS (South African Notional Accreditation System), which include ISO/IEC 17025:2005 standards**

Envirocare Laboratories however does have a mission and vision statement. The following information has been obtained by the owner.

3.5.1 Vision statement

(Envirocare)

“To provide outstanding service and reliable results to all our customers within the shortest turn-around time possible.” (From Envirocare quality manual)

3.5.2 Mission statement

(Envirocare)

“Envirocare offers high quality analysis and reliable results to customers using up to date technology and the latest innovative methods. Envirocare strives to keep the turn-around time to the minimum to make it possible for customers to deliver safe products.”

Part of being accredited with SANAS, Envirocare must have a quality manual. The following information has been taken from the Quality Manual of Envirocare,

3.5.3 Quality policy statement

(Quality manual for Envirocare)

“I, Ilse Simpson, herewith state that Envirocare will provide micro-biological and consultancy services to:

1. Deliver quality results timeously.
2. Satisfy the need of the customer.
3. Comply with the requirements of ISO17025 and SANAS, and
4. Comply with Envirocare own policies and procedures.

In so doing Envirocare Laboratories strives to act;

1. Professionally,
2. With integrity, and
3. “Endeavours to improve the quality system continually.”

3.5.4 Management objectives and responsibilities

(From the quality Manual of Envirocare)

“It is the objective of the management of the laboratory and the responsible staff to provide analytical, and consultancy services in accordance with the best applicable standards and in so doing to satisfy the requirements and expectations of its customers.”

“It is the responsibility of all laboratory staff at whatever level to familiarise themselves, with the content and requirements of the Quality Manual and to comply with the policies and procedures laid down in that manual and associated documentation at all times.”

3.6 BUSINESS STRATEGY

The business strategy, business risk and cost drivers of Envirocare Laboratories have been investigated. The researcher, with the help of the business owner, has completed a **SWOT** analysis, indicating the current strengths, weaknesses, opportunities and threats of this business.

3.6.1 SWOT analysis

The current strategy and SWOT analysis of Envirocare has been obtained through an interview.

The Strengths, Weaknesses, Opportunities and Threats analysis is one tool that most small business owners neglect. But it is very important to implement this tool even in a small business to analyse a strategic plan for a small business. A SWOT analysis allows the owner to identify new markets, as well as prepare for perceived downturns or competition. It is a valuable tool to aid the process of strategic planning. A study has been made of the opportunities and threats in the external environment of Envirocare Laboratories. The key however, is to eliminate weaknesses and threats

and to capitalise on the opportunities and strengths. Below is the SWOT analysis as compiled after an interview with owner.

3.6.2 Envirocare SWOT-analysis currently

POTENTIAL RESOURCES	STRENGTHS
Powerful strategy	There is no powerful strategy at this point of time.
Strong financial condition	The financial condition will be determined once a careful analysis was done by using the cash-flow statement, income statement and the balance sheet. The different ratios will be used to determine the financial position of the researched small business.
Strong brand name / image / reputation	The brand name is strong in the North West Province, but needs to be increased in the Northern Cape and Free State Area.
Widely recognised market leader	No, Envirocare is a small business which is SANAS accredited, giving personalised customer care to a small group of customers.
Propriety technology	Using ISO 17025
Cost advantages	One owner business with little overheads
Strong advertising	None, only by “word of mouth”
Product innovation skills	The owner will use accredited specified laboratory methods for individual customer needs.
Good customer service	Excellent, tailor made for each individual customer
Better product quality	SANAS accreditation methods
Alliance or joint venture	Currently exploiting JV with Supreme

	Poultry.
POTENTIAL RESOURCES	WEAKNESSES
No clear strategic vision	Not at this stage
Obsolete facilities	Some equipment were bought new, some leased from the NWU
Weak balance sheet, excess debt	To be determined
Higher overall costs than rivals	No, lower
Missing some key skills, competencies	Certainly
Subpar profit	No
Internal operating problems	No
Falling behind in R&D	No R&D at this stage.
Too narrow product line	Broadened by customer expectations
Weak marketing skills	Certainly
POTENTIAL RESOURCES	OPPORTUNITIES
Serving additional customer groups	Yes
Expanding to new geographical areas	No
Expanding the product line	Yes, by customer demand
Transferring skills to new products	Certainly
Vertical Integration	On a small scale
Take market share from rivals	Yes
Acquisition of rivals	No
Alliances or Joint Ventures to expand coverage	In the pipeline
Openings to exploit new technologies	No
Openings to extend brand name/image	No
POTENTIAL RESOURCES	THREATS
Entry of potent new competitors	No

Loss of sales to substitutes	Yes, due to company regulations
Slowing market growth	None at this stage
Adverse shifts in exchange rates & trade policies	No
Costly new regulations	Yes, SANAS accreditation
Vulnerability to the business cycle	Yes
Growing leverage of customers or suppliers	Yes
Reduced buyer needs for product	Yes, due to market economy
Demographic changes	None

3.6.3 Core principles

The core principles are the foundations on which any organisation is build. These principles represent the core essence of each company.

The following core principles were identified in conjunction with the owner of Envirocare Laboratories, and are applicable to this small to medium enterprise:

- Supplying results to a differentiated niche market.
- Focusing on individual customers with specified needs.
- Concentrating on high technical ability.
- Ensuring super-fast service with a 48 hours turn-around time.
- Doing analysis 24/7, including over weekends.
- Accreditation of additional laboratory methods at customers' request.
- Making a substantial profit without ripping the customer off.

3.6.4 Porters five forces

The Porters five forces model was used during the interview with the owner of the business to identify the different forces that has an influence on any business and is officially called the “The Five Forces Model of Competition”. The model used to determine the nature and strengths of competitive pressures in the business industry

– micro-laboratories. The five competitive forces include competing from rival sellers, competition from potential new entrants to the industry, competition from substitute products, supplier bargaining power and customer bargaining power. The researcher needed to show, in conjunction with the owner, the different forces within the industry where Envirocare operates. *Below is a summary of the interview.*

3.6.4.1 Rivalry among competing sellers:

As indicated, this force can be seen as competitive pressures coming from other firms in the industry. The interview indicated that the competitive forces from competing sellers were not high. Due to very low overhead costs, the small business (Envirocare) being researched, can afford to have selling prices 20-30% below that of the competing companies. In addition, the competitors are situated further from the customers, whereas the competitors are mostly situated outside the North West boundaries, in Gauteng. This is an advantage for the small business's owner, since courier cost which is included in the price of analyses done, can increase the selling price substantially.

3.6.4.2 Competing from potential new entrants:

Competitive pressures coming from the threat of entry of new rivals, was not high. The main reasons for this being the following:

- Due to technical knowledge and experience not many small businesses do enter this market (Niche market).
- The strategy for the small business being researched can be described as a small niche market strategy, if the SANAS accreditation process is included into the equation, it becomes quite clear that the small business being researched has quite a few advantages and that entrance from other business were highly unlikely.

3.6.4.3 Firms in other industries offering substitute products

Competing pressures coming from producers of substitute products, were highly unlikely for the following reasons:

- The small business in question does not manufacture products but sells results.
- The results being produced is in accordance with the ISO 170125 (SANAS) quality system.
- The results being produced required a micro biologist with a micro-laboratory.
- The small business being researched is thus applicable within a small niche market strategy with a level of differentiation.

There is therefore no high pressure within this force to offer substitute products or services.

3.6.4.4 Suppliers

Competitive pressures stemming from supplier bargaining power is quite low. The small business is keeping payables around 50 – 60 days to ensure that a good relationship is maintained between the business itself and its main suppliers. According to Thompson, Peteraf, Gamble and Strickland (2012:115), the following reasons may apply when pressure from suppliers is weak:

- Goods supplied by suppliers are readily available.
- There is a surge in the availability of suppliers.
- The small business in question can switch between suppliers, with relatively low switching cost involved.

The small business in question chooses to build up a relationship with a few good suppliers and therefore switching from one supplier to the next is not an option.

3.6.4.5 Buyers

The competitive pressures stemming from buyer bargaining power, shows what power the customer has over its suppliers. In the small business researched, it seems clear that by using a strategy of differentiation and choosing a niche market, the small business in question has eliminated most of the variables which ensures strong bargaining power. The buyer in this instance (customer) has gained trust over

the years with the small business in question. In addition, the fact that the laboratory has gained 17025 SANAS accreditations has ensured an immediate sense of trustworthiness. In addition, the small business owner is also a SANAS accreditor, and does audits on other micro-laboratories as a consultant for SANAS frequently. The following reasons, give a clear indication why competitive pressures from buyers are weak:

- Buyer cost to switch to a new supplier is extremely high. The closest supplier that can supply SANAS accredited results is 150km into Gauteng.
- The small business is differentiating itself from its competitors' needs by focusing on the customer's needs.
- Each time a customer is requesting a new method of analysis, the owner of the laboratory will research the relevant method, implement it and accredit it to SANAS certification.

Thus by implementing the model of Porter, it can be clearly seen that the small business in question is well situated in the bargaining process.

3.7 SUMMARY

The researcher was able to answer all the relevant questions asked in Chapter one. The SME, Envirocare, has been exploited in terms of financial management ratios, managerial accounting principles as well as strategic issues. An in-depth understanding of the current strategy, the current business model, mode operation, financial results, current financial value added as well as what was required to obtain break-even-point in the business has been obtained.

CHAPTER 4

CONCLUSIONS

4.1 Introduction

As discussed in Chapter 1, the objective of the study was to help the SME, Envirocare Laboratory. This SME has been confronted with an interesting dilemma. Due to customer demand and supply, the current laboratory became too small for the enterprise to fulfil all its obligations. The SME needed to relocate its premises, but could it afford to do so. In addition, it has been discovered during the initial interview with the owner of the business, that the laboratory had no clear strategy and that new business has been obtained on an ad hoc basis through “word of mouth” references. The researcher has discovered that there is a desperate need not only for this SME but for other similar businesses to acquire relevant tools that will help them in making important decisions that will impact on the future of their businesses. The tools required are:

- Certain **financial management principles** that is essential to determine the day to day profitability of the business.
- Certain **managerial principles** that is required in making important decisions such as capital expenditure.
- Certain **strategy principles** necessary to plan the way forward.

These principles as explained in the previous chapters have been introduced in the SME called Envirocare. Detailed descriptions of the findings are given in Chapter 3 and the conclusions are described in 4.2.

4.2 Conclusions

The following conclusions can be derived from the interview which has been held with the business owner and the empirical study done on the SME, as well as the interpretation of the financial statements of Envirocare:

4.2.1 Financial management principles

- In terms of Financial Management, the ratios calculated by analysing the Financial Statements, clearly indicate that the SME called Envirocare is in a good position to make the change (move the laboratory) to the new premises in the CBD of Potchefstroom.
- The financial ratios clearly indicate that the SME called Envirocare demonstrates a good business sense and a secure financial position. Value is added and the owner of the business demonstrates good financial feel and application.
- It was clearly evident in the results obtained that most of the ratios as discussed (see tables) exhibit excellent values for such a small business.
- The debtors days came down significantly, but more focus should be demonstrated with regard to creditors. To summarize, the bulk of the ratios indicate that the owner demonstrate good financial sense and the business is secure at this point of time.
- The owner of the business has admitted during the follow up interview that the financial ratios gave the current business environment a new perspective and that the lack of knowledge within this field has led to it that the business has been steered into open waters without a purposeful drive and direction - thus a serious shortcoming has been identified.

4.2.2 Managerial accounting principles

The business owner has been surprised to see how low the break-even-point was, and how easy it was to apply such a principle. The cost to relocate the laboratory was understandably a sunken cost. The business owner indicated that Cost-Volume-Profit relations were invaluable for the future of the business. The pay-back period

identified for the relocation cost (moving the laboratory from the North-West University to the central business district of Potchefstroom) was very realistic to the owner of Envirocare. No other relevant cost principles have been implemented. None of the following relevant cost principles were relevant to this study - opportunity cost, special orders and relevant versus non-relevant cost.

4.2.3 Strategy management principles

- With regard to the strategy, it has been mentioned before that the owner of the SME called Envirocare, has no clear business strategy to run the business on a daily basis, no clear strategy to obtain new business, no clear strategy for budgeting for existing business or for new business, and no clear strategy to block out competitors, and no clear vision on how the SME called Envirocare differentiates itself from competitors.
- It must be mentioned that the SME called Envirocare does have a Mission Statement and a Vision Statement and core values which are applied to the business have been identified during the interview with the owner.
- The business owner has admitted during the follow-up interview that the SME called Envirocare has a serious shortfall in knowledge as well as application within the strategy framework of the business.

4.3 RECOMMENDATIONS

4.3.1 Financial management principles

It is the recommendation of the researcher that an income statement and balance sheet should be drawn up on a monthly basis. This information should be used to determine the financial ratios every month. As part of a regular schedule the researcher recommends the following ratios monthly:

- The firm's free cash-flow.
- Liquidity ratios.
- Activity ratios.
- Profitability ratios.

Because the SME in this instance is a one man operation, the business owner of Envirocare in conjunction with the financial advisor, should evaluate the following monthly:

- Credit worthiness.
- Debtors.
- Short-term liquidity.
- Profitability.
- Future risk and return.
- Current risk and return.
- Overall financial health.

The owner of the business should compare the business's performance of the current vs. the previous year on a regular basis. In addition the researcher recommends that the owner should compare ratios of the business to those of other benchmark firms in the **same industry**. This kind of valid information should give the business owner an objective overview of the business to make sure that decisions are made on actual information interpreted and not on a gut feeling.

The following managerial accounting recommendations are summarised.

4.3.2 Managerial accounting principles

The principle of cost-volume-profit is a huge benefit for Envirocare. It has indicated the break-even-point. It helps the business owner to understand how profit are affected by selling prices, sales volume, unit variable cost, total fixed cost and mix of products being sold. Future principles recommended should include:

- Activity-based costing.
- Profit planning & budgeting.
- Relevant cost and decision making.
- Capital budgeting process.
- The time value for money.

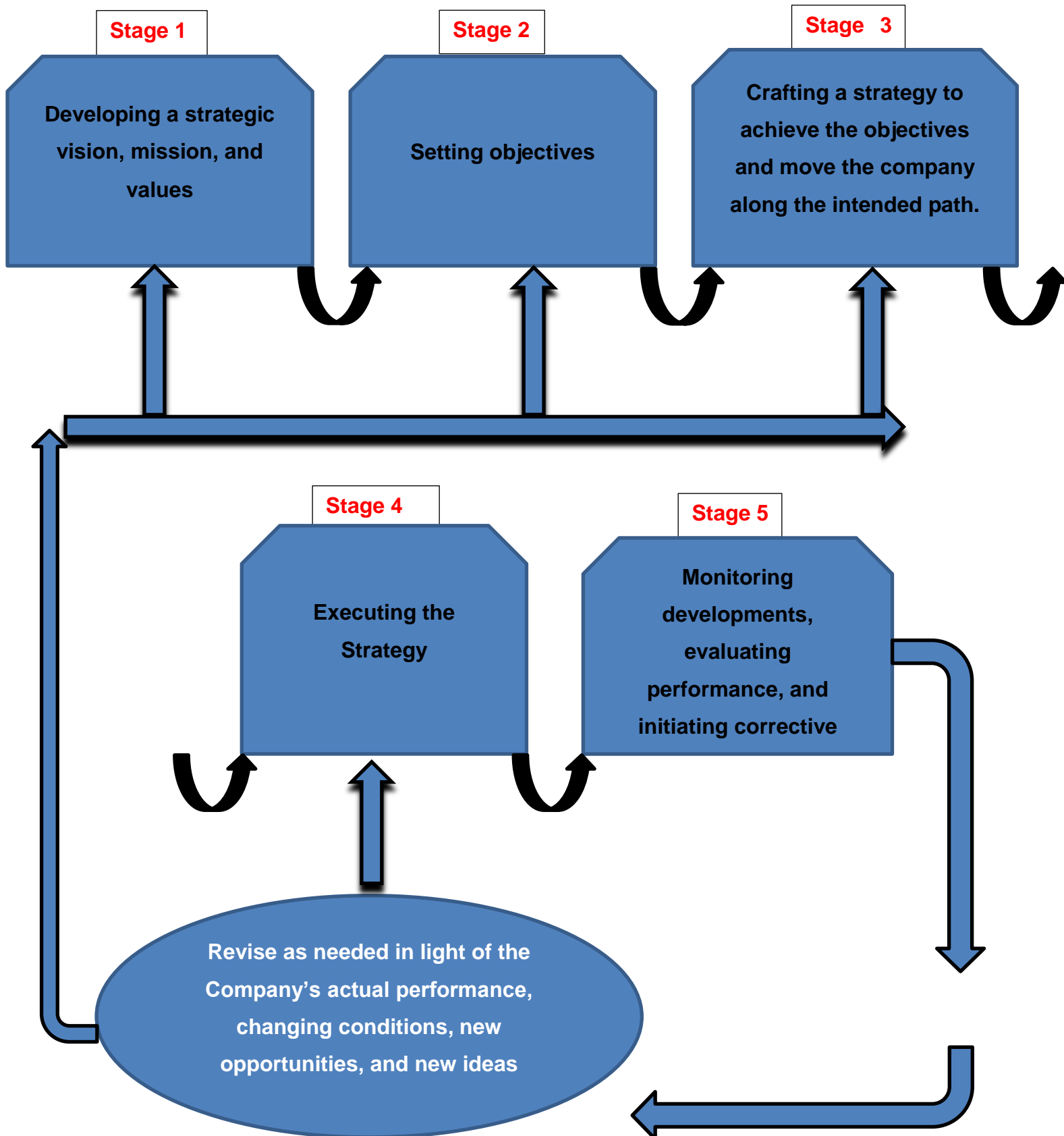
The researcher also recommends that the owner of the SME called Envirocare should enrol in a course for business management. The Middle Management Program at the North-West University's Business School will enable the business owner to be empowered with all the necessary tools to take Envirocare successfully to the future.

4.3.3 Strategy

In terms of Strategy for Envirocare, it is recommended that the business owner implement a "Strategy-Making, Strategy-Executing Process" as described by Thompson *et al.* (2012:70). The following Figure displays the five stage process whereby a strategy is compiled and executed which could assist the business owner in forming a clear strategy for the small business called Envirocare. The figures is described in detail by Thompson *et al.* (2012:70).

FIGURE 4.3

The Strategy-making, Strategy-executing process as described by Thompson *et al.* (2012:70)



It is recommended that the small business Envirocare will implement all five stages of this proposed model. As illustrated, the following five stages are of importance,

- **Stage 1**, this has been implemented.
- **Stage 2**, clear objectives needs to be set.
- **Stage 3**, crafting a strategy.
- **Stage 4**, implement the strategy.
- **Stage 5**, monitor the development; evaluating the performance and initiative of the corrective action.

Part of stage 3 is the SWOT analysis and the implementing of the Five Forces of Porter as part of the medium to long-term strategy. These models should be reviewed once a year as part of the business owner's planning to determine its current location within the strategy plan. The owner should also, on a regular basis, determine the business risk in the current economic climate.

4.3 ACHIEVEMENT OF THE STUDY'S OBJECTIVES

The researcher feels that the research study has met all its objectives. It was the aim of the researcher to look at the micro-laboratory, Envirocare, in a holistic way. Small to medium business owners are confronted with decisions daily, decisions that can change the future of the business instantly. To study a Small to Medium Enterprise (SME), it is important to look at the business from three different angles: managerial accounting principles, financial management principles as well strategy management all form part of a business triangle. This business triangle focuses on the elements of what a business is and what makes a business successful. This study has dealt in relative depth with the business called Envirocare. The researcher has answered important questions and important decisions can be made within the business, due to the fact that the research has shed new light on important information within the business. All of the questions asked in Chapter 1 were answered.

4.4 RECOMMENDATIONS FOR FUTURE RESEARCH

The researcher feels that a recommendation for future research is definitely motivated. There is a huge void within the small to medium businesses for practical implementation for strategy, as well as basic managerial guidelines and financial management ratios. Not every business owner is aware or has the time or money to spend on an Honours or Master's degree of Business Administration. Small business owners and entrepreneurs will welcome basic guidelines on "how to run a successful business". This entitlement will add to the GDP of our country as well as ensure job creation in our stricken growing economy.

4.5 SUMMARY

With regard ***financial management***, the owner of Envirocare will greatly benefit if the ratios as explained within this research are implemented within Envirocare on a monthly basis. These ratios will lead the owner of the business to make more rational decisions regarding the day to day operations of the business.

The final principle namely, ***managerial accounting management***, is hugely underutilised within this research. As mentioned earlier within this chapter, the owner of Envirocare is strongly advised to become acquainted with the following principles in this study field:

- Activity-based costing.
- Profit planning & budgeting.
- Relevant cost and decision making.
- Capital budgeting process.

The owner of the SME called Envirocare is strongly advised in terms of ***strategy***, to implement the Strategy-Making, Strategic thinking process as well as:

- Implement the SWOT analysis and update it yearly.
- Implement the Five Forces of Porter and revisit it yearly.
- Analyse the risks within the business and revisit it yearly.

- Conform to proper planning methods as indicated.
- Implement the suggested pricing policies.
- The time value for money.

By mastering these principles, the business owner will be able to manage a very successful micro laboratory called Envirocare.

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ANNEXURES

FORMULAS

RETURN OF ASSETS

$$ROA = \frac{\text{Earnings available for common stockholders}}{\text{Total Assets}} = \% \text{ or } ROA = \frac{\text{Profits after tax Interest}}{\text{Total assets}} = \%$$

RETURN OF EQUITY

$$ROE = ROA \times A/E$$

$$ROE = \frac{\text{Earnings available for common stockholders}}{\text{Common stock equity}} \times \frac{\text{Total Assets}}{\text{Common stock equity}} = \% \text{ or }$$

$$ROE = \frac{\text{Profits after tax}}{\text{Total stock holders equity}} = \%$$

GROSS PROFIT

$$GM = \frac{\text{Gross Profit}}{\text{Sales}} = \% \quad \text{or } GM = \frac{\text{Revenue} - \text{Cost of goods sold}}{\text{Revenue}} = \%$$

OPERATING PROFIT

$$OPM = \frac{\text{Operating Profit}}{\text{Sales}} = \% \text{ or Return on Sales} = \frac{\text{Revenue} - \text{Operating Expenses}}{\text{Revenue}}$$

NET PROFIT MARGIN

$$NP = \frac{\text{Earnings available for common stockholders}}{\text{Sales}} = \%$$

RETURN ON INVESTED CAPITAL

$$\frac{\text{PROFIT AFTER TAXES}}{\text{LONG - TERM DEBT} + \text{TOTAL EQUITY}}$$

CURRENT RATIO

$$\frac{\text{CURRENT ASSETS}}{\text{CURRENT LIABILITIES}}$$

WORKING CAPITAL

$$\text{CURRENT ASSETS} - \text{CURRENT LIABILITIES}$$

DEBT-TO-ASSETS RATIO

$$\frac{\text{TOTAL DEBT}}{\text{TOTAL ASSETS}}$$

LONG-TERM DEBT-TO-CAPITAL RATIO

$$\frac{\text{LONG - TERM DEBT}}{\text{LONG - TERM DEBT} + \text{TOTAL STOCKHOLDERS EQUITY}}$$

DEBT-EQUITY RATIO

$$\frac{\text{TOTAL DEBT}}{\text{TOTAL STOCKHOLDERS EQUITY}}$$

LONG-TERM DEBT-TO-EQUITY RATIO

$$\frac{\text{LONG - TERM DEBT}}{\text{TOTAL STOCKHOLDERS EQUITY}}$$

DAYS OF INVENTORY

$$\frac{\text{INVENTORY}}{\text{COST OF GOODS SOLD}/365}$$

INVENTORY TURNOVER

$$\frac{\text{COST OF GOODS SOLD}}{\text{INVENTORY}}$$

AVERAGE COLLECTION PERIOD

$$\frac{\text{ACCOUNTS RECEIVABLE}}{\text{TOTAL SALES}/365}$$

OR

$$\frac{\text{ACCOUNTS RECEIVABLE}}{\text{AVERAGE DAILY SALES}}$$

INTERNAL CASH-FLOW

FCF = AFTER TAX PROFIT + DEPRECIATION – CAPITAL EXPENDITURES -
DIVIDENDS

COST-VOLUME-PROFIT (CVP) ANALYSIS

PROFIT = (SALES – VARIABLE EXPENSES) – FIXED EXPENSES

SALES = VARIABLE EXPENSES + FIXED EXPENSES + PROFIT

BREAK-EVEN-POINT

TOTAL FIXED COST / [1- (TOTAL VARIABLE COST / TOTAL SALES)] = BREAK
EVEN SALES

CALCULATIONS

	2011	2012
GROSS PROFIT MARGIN	$=941943 - (23400 + 347588 + 30540) / 918543$	$=1224470 - (23400 + 507739 - 12100) / 1224470$
OPERATING PROFIT MARGIN	$=35736 / 941943 * 100$	$=78998 / 1236570 * 100$
NET PROFIT MARGIN	$=25730 / 941943 * 100$	$=78998 / 1236570 * 100$
RETURN ON TOTAL ASSETS	$=(25730 + 7799) / 269776 * 100$	$=(78998 + 377) / 217978 * 100$
RETURN ON STOCKHOLDERS EQUITY	$=25730 / 115328 * 100$	$=78998 / 194326 * 100$
RETURN ON INVESTED CAPITAL	$=25730 / (143522 + 115328) * 100$	$=78998 / (9711 + 194326) * 100$
CURRENT RATIO	$=232397 / 10926$	$=180599 / 13941$
WORKING CAPITAL	$=232397 - 10926$	$=180599 - 13941$
DEBT-TO-ASSET RATIO	$=(143522 + 10926) / 269776$	$=(9711 + 13941) / 217978$
LONG-TERM-DEBT-TO CAPITAL-RATIO	$=143522 / (143522 + 115328)$	$=9711 / (9711 + 217978)$
DEBT-EQUITY-RATIO	$=(143522 + 10926) / 269776$	$=(9711 + 13941) / 217978$
LONG-TERM-DEBT-TO-EQUITY-RATIO	$=(143522 + 10926) / 115328$	$=(9711 + 13941) / 194316$
DAYS OF INVENTORY	N/A	N/A
INVENTORY TURNOVER	N/A	N/A
AVERAGE COLLECTION PERIOD	$=178500 / 2580.67$	$=144936 / 3387.86$
AVE DAILY SALES	$=941943 / 365$	$=1236570 / 365$
INTERNAL CASH-FLOW	$=25730 + 89558$	$=194316$

FREE CASH-FLOW	=25730+89558	=194316
FIREPROOF	=(232397-23400)/10926	=(180599-12100)/13941

FINANCIAL STATEMENTS

ENVIROCARE: YEAR END FEBRUARY 2010/2011

Chisik Trading BKBALANSSTAAT OP 28 FEBRUARIE 2011

<u>BATES</u>	<u>Aant.</u>	<u>R</u> <u>2011</u>	<u>R</u> <u>2010</u>
<u>Nie bedryfsbates</u>			
<u>Tasbare bates</u>		37,379	70,886
Vaste Bates	3	37,379	70,886
<u>Bedryfsbates</u>		232,397	131,595
Voorraad		23,400	30,540
Debiteure		178,500	100,386
SARS		76	-
Kontant en kontantekwivalente		30,421	669
TOTALE BATES		269,776	202,481
 <u>LEDEFONDSE EN VERPLIGTINGE</u>			
<u>Ledefondse en reserwes</u>		115,328	89,598
Ledebydraes	2	10	10
Onverdeelde winste		115,318	89,588
<u>Nie-bedryfslaste</u>		143,522	82,000
Ledelening	4	143,522	82,000
<u>Bedryfs Laste</u>		10,926	30,883
Btw Kontrole		10,926	17,470
SARS		-	13,413
TOTALE FONDSE EN VERPLIGTINGE		269,776	202,481

Chisik Trading BKINKOMSTESTAAT VIR DIE TYDPERK GEËNDIG 28 FEBRUARIE 2011

	<u>Aant</u>	<u>R</u> <u>2011</u>	<u>R</u> <u>2010</u>
Inkomste		941,943	854,769
Dienste gelewer		918,543	824,229
Voorraad 28.2.2011		23,400	30,540
Min: Uitgawes		906,207	799,672
Aankope		337,588	363,280
Assuransie en lisensies		-	4,750
Bankkoste		4,837	4,752
Huur		69,275	74,327
Ledeversoeding		250,000	180,000
Motoroute		29,260	20,849
Onthaal en geskenke		13,397	9,630
Rekenmeestersversoeding		8,524	5,324
Rente		7,799	8,072
Reparasies en onderhoud		-	1,291
Salarisse en lone		112,738	68,000
Telefoon en skryfgoed		8,742	13,323
Voorraad 1.3.2010		30,540	15,300
Waardevermindering	3	33,507	30,774
Netto Inkomste/verlies vir die jaar		35,736	55,097
Ander Inkomstes - Rente		-	-
Netto inkomste/verlies voor belasting		35,736	55,097
Belasting	5	10,006	-
Netto inkomste/verlies na belasting		25,730	55,097
Onaangewende Inkomste in begin van jaar		89,588	34,491
Onaangewende Inkomste vir die jaar 2011		<u>115,318</u>	<u>89,588</u>

Chisik Trading BK

STAAT VAN VERANDERINGS IN EKWITEIT

		Onverdeelde		
		Ledebydrae	Winste	Totaal
Saldo	1 Augustus 2007	0	0	0
Netto Verlies na belasting	29 Februarie 2008	10	89,588	89,598
		10	89,588	89,598
Saldo	1 Maart 2008	10	-737	-727
Netto wins na belasting	28 Februarie 2009		35,228	35,228
		10	34,491	34,501
Saldo	1 Maart 2009	10	34,491	34,501
Netto wins na belasting	28 Februarie 2010		55,097	55,097
		10	89,588	89,598
Saldo	1 Maart 2010	10	89,588	89,598
Netto wins na belasting	28 Februarie 2011		25,730	25,730
		10	115,318	115,328

Chisik Trading BK

KONTANTVLOEIESTAAT VIR DIE TYDPERK GEËINDIG 28 FEBRUARIE 2011

		R 2011	R 2010
<u>Kontant teruggehou uit bedryfsaktiwiteite:</u>			
Kontant deur bedrywighede voortgebring		77,042	93,943
Afname in Bedryfskapitaal	1	-77,518	28,646
Rente betaal		-7,799	-8,072
Belasting betaal	2	-23,495	0
Kontant deur Bedryfsaktiwiteite Voortgebring		-31,770	114,517

Kontant uit Beleggingsaktiwiteite

Aankoop van bates	-	-8,947
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<u>Kontantgevolge van Finansieringsaktiwiteite:</u>	61,522	-106,366
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Toename/(Afname) in Ledebydraes	0	0
Toename/(Afname) in Lenings	61,522	-106,366

Kontant en kontantekwivalente aan die begin van die jaar	669	1,465
Kontant en kontantekwivalente aan die einde van die jaar	30,421	669

1 Toename / (Afname) in Bedryfskapitaal

(Toename)/Afname in voorraad	7,140	-15,240
(Toename)/Afname in debiteure	-78,114	30,408
Toename/(Afname) in krediteure	-6,544	13,478
	-77,518	28,646

2 Voorsiening vir belasting

Bedrag aan begin van die jaar	-13,413	-13,413
Bedrag in inkomstestaat gedebiteer	-10,006	0
Bedrag aan einde van die jaar	-76	13,413
	-23,495	0

Chisik Trading BK

AANTEKENINGE TOT DIE FINANSIËLE STATE VIR DIE TYDPERK GEËNDIG 28 FEBRUARIE 2011

1 Rekeningkundige Beleid

Die finansiële state word opgestel in ooreenstemming met algemeen aanvaarde rekeningkundige praktyk soos toepaslik op die besigheid van die beslote korporasie, welke beginsels konsekwent toegepas is. Die hoof rekeningkundige beleid van die Maatskappy is soos volg:

1.1 Grondslag van aanbieding

Die finansiële state word op die historiese koste grondslag opgestel.

1.2 Doelstelling:

Water en relevante aktiwiteite

1.3 Vaste Bate en waardevermindering

Vaste bates word getoon teen kosprys min opgehoopte waardevermindering.

Bates word oor hulle verwagte ekonomiese lewensduur afgeskryf volgens die reguitlyn metode.

Voertuie - 5jaar

Toerusting - 4jaar

2 LEDEBYDRAES

	<u>Verhouding</u>	<u>2011</u>	<u>2010</u>
I Simpson	50%	5	5
G Simpson	50%	5	5
		<u>10</u>	<u>10</u>

3 Vaste Bates

	<u>Kosprys</u>	<u>Opgehoopte- Waarde- vermindering</u>	<u>Saldo 1.3.2010</u>	<u>Waardever- mindering</u>	<u>Saldo 28.2.2011</u>
Toyota Corolla (2003)	82,000	57,400	41,000	16,400	24,600
Toerusting	56,500	49,438	21,188	14,125	7,063
Lugversorger	8,947	3,231	8,698	2,982	5,716
R	<u>147,447</u>	<u>110,069</u>	<u>70,886</u>	<u>33,507</u>	<u>37,379</u>

Langtermynverpligtinge

4

Ledelening - I Simpson	<u>143,522</u>	<u>82,000</u>
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Die lening is rentevry en geen voorwaardes van terugbetaling bestaan nie.

5 Belasting

Netto inkomste	35,736
Belasbare inkomste	<u>35,736</u>
Belasting @ 28% - Kleinsake dus geen voorsiening	<u>10,006</u>

ENVIROCARE: YEAR END FEBRUARY 2011/2012

**CHISIK TRADING 57 BK
FINANSIËLE JAARSTATE
vir die jaar geëindig 29 Februarie 2012**

Die verslae en state wat hieronder uiteengesit word, behels die finansiële jaarstate wat aan die lede voorgehou word:

Indeks

Verslag van die rekenkundige beamppte	2
Balansstaat	3
Inkomstestaat	4
Aantekeninge tot die finansiële state	5

Goedkeuring en verantwoordelikhedsverklaring

Die finansiële state wat op bladsye 3 tot 7 verskyn, is op 5 April 2012 deur die lid goedgekeur.

Die lid is verantwoordelik vir die handhawing van toereikende rekenkundige verslae, sowel as die opstel en volledigheid van die finansiële state en verwante inligting. Die rekenkundige beamppte is daarvoor verantwoordelik om te bepaal of die finansiële state in ooreenstemming met die rekenkundige rekords is en saamgevat is op die wyse wat deur artikel 58(2)(d) van die wet vereis word.

Die lid is ook verantwoordelik vir die korporasie se stelsel van interne finansiële beheer. Dit is ontwerp om redelike maar nie absolute sekerheid nie, t.o.v. die betroubaarheid van die finansiële state te bied en bates toereikend te beveilig, te kontroleer en verantwoordelikheid daarvoor te handhaaf, sowel as om wanverklarings en verlies op te spoor en te verhoed. Die lid het nie verneem van enige iets wat 'n aanduiding kon wees dat enige wesenslike gebrek t.o.v. die funksionering van die beheermaatreels, prosedures en stelsels gedurende die oorsigjaar plaasgevind het nie.

Die finansiële state is op die grondslag van die lopende onderneming opgestel aangesien die lid alle rede het om te glo dat die korporasie oor die voldoende middele beskik om sy bedrywighede in die afsienbare toekoms voor te sit.

I Simpson

G Simpson

Potchefstroom

05 April 2012

CHISIK TRADING BK**BALANSSTAAT OP 28 FEBRUARIE 2012**

<u>BATES</u>	<u>Aant.</u>	<u>R</u> <u>2012</u>	<u>R</u> <u>2011</u>
<u>Nie bedryfsbates</u>			
<u>Tasbare bates</u>		172,038	37,379
Vaste Bates	3	172,038	37,379
<u>Bedryfsbates</u>		215,068	232,397
Voorraad		13,005	23,400
Debiteure		178,500	178,500
SARS		-	76
Kontant en kontantekwivalente		23,563	30,421
TOTALE BATES		387,106	269,776
 <u>LEDEFONDSE EN VERPLIGTINGE</u>			
<u>Ledefondse en reserwes</u>		142,059	115,328
Ledebydraes	2	10	10
Onverdeelde winste		142,049	115,318
<u>Nie-bedryfslaste</u>		230,790	143,522
Ledelening	4	230,790	143,522
<u>Bedryfs Laste</u>		14,257	10,926
Btw Kontrole		13,941	10,926
SARS		316	-
TOTALE FONDSE EN VERPLIGTINGE		387,106	269,776

CHISIK TRADING BK**INKOMSTESTAAT VIR DIE TYDPERK GEËNDIG 28 FEBRUARIE 2012**

	<u>Aant</u>	<u>R</u> <u>2012</u>	<u>R</u> <u>2011</u>
Inkomste		1,237,470	941,943
Dienste gelewer		1,224,465	918,543
Voorraad 28.2.2012		13,005	23,400
Min: Uitgawes		1,200,343	906,207
Aankope		528,740	337,588
Assuransie en lisensies		14,865	-
Bankkoste		6,604	4,837
Huur		67,242	69,275
Ledevergoeding		330,000	250,000
Motorkoste		45,178	29,260
Onthaal en geskenke		15,107	13,397
Rekenmeestersvergoeding		8,000	8,524
Rente		-	7,799
Reparasies en onderhoud		701	-
Salarisse en lone		107,100	112,738
Telefoon en skryfgoed		12,315	8,742
Voorraad 1.3.2011		23,400	30,540
Waardevermindering	3	41,091	33,507
Netto Inkomste/verlies vir die jaar		37,127	35,736
Ander Inkomstes - Rente		-	-
Netto inkomste/verlies voor belasting		37,127	35,736
Belasting	5	10,396	10,006
Netto inkomste/verlies na belasting		26,731	25,730
Onaangewende Inkomste in begin van jaar		115,318	89,588
Onaangewende Inkomste vir die jaar 2012		142,049	115,318

CHISIK TRADING BK**STAAT VAN VERANDERING IN EKWITEIT**

		Onverdeelde		
		Ledebydrae	Winste	Totaal
Saldo	1 Augustus 2007	0	0	0
Netto Verlies na belasting	29 Februarie 2008	10	115,318	115,328
		10	115,318	115,328
Saldo	1 Maart 2008	10	-737	-727
Netto wins na belasting	28 Februarie 2009		35,228	35,228
		10	34,491	34,501
Saldo	1 Maart 2009	10	34,491	34,501
Netto wins na belasting	28 Februarie 2010		55,097	55,097
		10	89,588	89,598
Saldo	1 Maart 2010	10	89,588	89,598
Netto wins na belasting	28 Februarie 2011		25,730	25,730
		10	115,318	115,328
Saldo	1 Maart 2011	10	115,318	115,328
Netto wins na belasting	28 Februarie 2012		26,731	26,731
		10	142,049	142,059

CHISIK TRADING BK**KONTANTVLOEIESTAAT VIR DIE TYDPERK GEËINDIG 28 FEBRUARIE 2012**

		<u>R</u> <u>2012</u>	<u>R</u> <u>2011</u>
<u>Kontant teruggehou uit bedryfsaktiwiteite:</u>			
Kontant deur bedrywighede voortgebring		78,218	77,042
Afname in Bedryfskapitaal	1	13,410	-77,518
Rente betaal		-	-7,799
Belasting betaal	2	-10,004	-23,495
Kontant deur Bedryfsaktiwiteite Voortgebring		<u>81,624</u>	<u>-31,770</u>

Kontant uit Beleggingsaktiwiteite

Aankoop van bates	-175,750	-
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Kontantgevolge van Finansieringsaktiwiteite:

Toename/(Afname) in Lenings	87,268	61,522
Kontant en kontantekwivalente aan die begin van die jaar	<u>30,421</u>	<u>669</u>
Kontant en kontantekwivalente aan die einde van die jaar	<u>23,563</u>	<u>30,421</u>

1 Toename / (Afname) in Bedryfskapitaal

(Toename)/Afname in voorraad	10,395	7,140
(Toename)/Afname in debiteure	0	-78,114
Toename/(Afname) in krediteure	<u>3,015</u>	<u>-6,544</u>
	<u>13,410</u>	<u>-77,518</u>

2 Voorsiening vir belasting

Bedrag aan begin van die jaar	76	-13,413
Bedrag in inkomstestaat gedebiteer	-10,396	-10,006
Bedrag aan einde van die jaar	<u>316</u>	<u>-76</u>
	<u>-10,004</u>	<u>-23,495</u>

CHISIK TRADING BK

AANTEKENINGE TOT DIE FINANSIËLE STATE VIR DIE TYDPERK GEËNDIG 28 FEBRUARIE 2012

1 Rekeningkundige Beleid

Die finansiële state word opgestel in ooreenstemming met algemeen aanvaarde rekeningkundige praktyk soos toepaslik op die besigheid van die beslote korporasie, welke beginsels konsekwent toegepas is. Die hoof rekeningkundige beleid van die Maatskappy is soos volg:

1.1 Grondslag van aanbieding

Die finansiële state word op die historiese koste grondslag opgestel.

1.2 Doelstelling:

Water en relevante aktiwiteite

1.3 Vaste Bate en waardevermindering

Vaste bates word getoon teen kosprys min opgehoopte waardevermindering.

Bates word oor hulle verwagte ekonomiese lewensduur afgeskryf volgens die reguitlyn metode.

Voertuie - 5jaar

Toerusting - 4jaar

2 LEDEBYDRAES

	<u>Verhouding</u>	<u>2012</u>	<u>2011</u>
I Simpson	50%	5	5
G Simpson	50%	5	5
		<u>10</u>	<u>10</u>

3 Vaste Bates

	<u>Kosprys</u>	<u>Opgehoopte- Waarde- vermindering</u>	<u>Saldo 1.3.2011</u>	<u>Waardever- mindering</u>	<u>Saldo 28.2.2012</u>
Toyota Corolla (2003)	82,000	73,800	24,600	16,400	8,200
Audi A3 Sport (2008)	175,750	14,646	175,750	14,646	161,104
Toerusting	56,500	56,500	7,062	7,062	0
Lugversorger	8,947	6,213	5,716	2,982	2,734
R	<u>323,197</u>	<u>151,159</u>	<u>213,128</u>	<u>41,090</u>	<u>172,038</u>

Langtermynverpligtinge

4

Ledelening - I Simpson	<u>230,790</u>	<u>143,522</u>
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Die lening is rentevry en geen voorwaardes van terugbetaling bestaan nie.

5 Belasting

Netto inkomste	37,127
Belasbare inkomste	<u>37,127</u>
Belasting @ 28%	<u>10,396</u>

