Town and Country BUSINESS PROGRAM

KEY to Business Understanding

How Is Money Obtained for Marketing?

Finance and Risk Bearing

PURPOSE: To create an awareness of the need for financing by firms and consumers; and, to examine the accounting statements used by business to record its financial position.

Money is a "must" to start even the most simple business — a farm, small shop, store, or factory. Marketing is one of the functions of operating a business even though the firm may range in size from a small roadside market to a giant processor.

Let's say you live on a farm. Your father has given you an acre of land on which to plant sweet corn. You could sell this corn along with your Dad's crop at the processing plant, but you have a better idea. You'll build a stand and sell directly to motorists who drive along the highway.

But, the stand, even a simple one, costs money to build. You need money for lumber, nails, and a canvas awning to keep the produce protected from the sun. You have to buy some paper bags for packaging people's purchases. And, you would like to buy some other products at wholesale to diversify your business. For example, people who stop to buy sweet corn might want to buy some tomatoes, too.

How A Corporation Gets Money

You estimate your project will cost you $100 to get into business. This investment is known as capital. From where will the $100 come? You can get only $10 from your savings account. You may borrow the additional money at a bank, but for business purposes there are other sources of money, too.

You may decide to organize "Garden Fresh, Incorporated" to market your products. The privilege of organizing a corporation and selling shares of stock is regulated by government, so certain legal procedures must be followed in setting up your firm. After you have completed these requirements, you may sell shares in "Garden Fresh, Inc." at $25 per share, so you would have to sell four shares to get the needed capital. But, it's much easier to sell 20 shares at $5 each, and then some of your classmates might be able to afford to buy shares.

As you sell shares in "Garden Fresh, Inc.," the shareholders become part owners in the company. If the company makes money, they will share in the profits. If "Garden Fresh, Inc." loses money to the point of bankruptcy, the shareholders may lose their entire investment.

Since the shareholders are part owners of the company, they want to have a voice in its management — how you run the company. They will elect representatives to be on your board of directors. They

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will vote on these representatives, based on the articles of incorporation and the shares of stock they own. Thus, if some person has purchased five shares, he would be entitled to ¼ of the voice in management of the company.

Now, if one of your shareholders needed his money during the summer, he would have to sell his stock. The price he could get for the stock would depend on the eagerness of people to be part owners of "Garden Fresh, Inc." If your business appeared to be making a profit with prospects for even greater growth, people may want to buy shares of "Garden Fresh, Inc." and be willing to pay more than the original $5 for the stock.

Part or all of the profits may be distributed among the stockholders. These returns are called dividends. They are not guaranteed and can be paid only after all other obligations are met. The board of directors, however, may decide to retain a part of the profits to re-invest in the business for a refrigerated display or some other item to stimulate sales.

On the other hand, a drop in sales or some other discouraging experience at "Garden Fresh, Inc." might make some of the present stockholders willing and even glad to sell for less than the $5 they originally paid for "Garden Fresh, Inc." shares.

Each shareholder in "Garden Fresh, Inc." will be entitled to his proportionate share in the profits of the firm. If "Garden Fresh, Inc." goes out of business and sells its equipment, shareholders receive proportionate shares of the money from the sale. The successful corporation, however, continues to operate after the founders leave the firm — an advantage of the corporate-type organization.

Let's also study how other business organizations get the money they need for marketing and other purposes.

Proprietorship: this type of firm usually has a relatively small investment, compared with other types of organizations. The owner acquires his money from his own savings or by borrowing from a bank or individual.

Partnership: this arrangement usually provides greater access to money because more than one person is involved in the business. Sometimes each partner will contribute equal amounts of capital, but many other kinds of arrangements can be made. Indeed, in some partnerships one person will provide most of the capital to start the business, while another partner will supply labor and management skills as his contribution.

Cooperative: this structure consists of a group who organize to mutually perform specific services, especially for the membership. It will use many of the same means of acquiring funds as any regular business corporation. The big difference is that the co-op members or patrons are the source of a major portion of the money. The members buy stock issued by the co-op. Cooperatives which market farm products can secure capital by deducting a small amount from each bushel (or other unit) handled by the organization. In payment for such deductions the producer is issued a "certificate of indebtedness" or other evidences of ownership. During this period the cooperative has use of the money which really belongs to the patron or member.

Turning back now to our "Garden Fresh, Inc.," you need only a small amount of money. You sold stock to friends and neighbors to finance your business. Many small firms do exactly the same thing.

The buying and selling of the securities which finance regular business corporations is a highly specialized procedure. Most of the organized trading takes place on a stock exchange. Major cities have such exchanges, with the most important being located in New York and Chicago. Member firms of these stock exchanges have offices in nearly every city in the United States.

The *financing* function is the obtaining and handling of money to carry on the various aspects of the business. Wherever and whenever there is a time lapse in handling a product, money is tied up in the operation. Someone must finance this holding of goods. The period of time may be relatively short, as in the marketing of perishables (strawberries, lettuce); or the time can be long, a year or more, as in the marketing of most canned goods. Financing may take the easily recognized form of advances from various lending agencies or the more subtle form of tying up the owner's money. Regardless of the type, financing is a necessary activity in modern marketing.

The *risk-bearing* function is acceptance of the possibility of loss in the marketing of a product. Marketing, like every other form of business activity, involves risks. In fact, a very high proportion of the total risks involved in business operations occurs in the field of distribution. Risk goes hand-in-hand with the ownership of goods, and, like other functions of marketing, risks must be carried by someone; they cannot be eliminated. Various kinds of risks may be placed in the following classifications:

Physical risks — those which occur from natural hazards such as fire, wind, cold, heat or damage.

Market risks — those which occur from price declines because of quality deterioration; price changes because consumer demand declines and/ or supplies become very abundant; or price drops because general business conditions become unfavorable.

A marketer can minimize some of the *physical risks* by transferring them partially to an insurance company for a fee. For those commodities for which "future exchanges" exist, *market risks* can be reduced.

Remember the differences between the functions of financing and risk bearing. The need for financing is due to the lag in time between the purchase and disposal of products, while the need for risk bearing arises from the possibility of loss during the period that goods are held.

To this point financing and risk bearing have been presented only as they pertain to marketing. Now, let us consider the financial structure of business in a broader sense, regardless of the type of operation.

Every business enterprise must have an initial investment by its owners. People own or invest in businesses for income or profit, directly or indirectly. It is very unlikely that all of the capital needed in financing a business is furnished at all times by the owners. In a profitable business, however, a high proportion of the capital required will be furnished by the owners. If risk of loss were absent in a business, the management might succeed in borrowing the entire amount of needed capital.

Need For Accurate Accounting

Successful business management depends on accurate accounting records. Profits or losses at the end of a year are the net results of a series of financial transactions taking place during a specific period. These transactions are characterized by sales and operating expenses, such as the purchase of commodities, salaries, wages, heat, light, telephone, repairs, interest, taxes, and supplies.

At the end of each fiscal year, a 12-month period, all accounting records are summarized and presented in the form of two financial statements: the balance sheet and the profit and loss statement.

Balance Sheet. The balance sheet presents the financial picture of a business at a specified time. It is a statement showing all property owned by a business, with all claims against it. Therefore, a balance sheet has two main parts: (1) Assets — property owned by a business, and (2) Liabilities — what a business owes to creditors and owners.

The first part, assets, property owned by a business, represents money or things that can be converted into money for paying claims of creditors and owners of the business.

The second part of the balance sheet shows who has *claims* on the property listed as assets. Two groups may be listed as having claims on the property — creditors and owners. Creditors are people or firms that have extended credit in the form of cash, goods, or services to the business and have claims on the property equal to the money value of credit extended. Owners are those who have invested capital in the business. The claims of owners are secondary to those of creditors.

Profit and Loss Statement. The "P. & L." statement is often called the operating statement. It summarizes by sources the income received by the business and all expenses incurred over a limited period of time.

Uses of Financial Statements. There are two general groups of persons interested in what financial statements reveal: those having interest as owners or as management, and those outside of the business.

Those controlling a business are striving for efficiency, and financial statements are tools to measure the operations accurately. Financial statements are used by management to determine the success of the business.

Others interested in the business operations include creditors, investors, tax officials and government regulatory bodies. Creditors — whether they are sellers of goods or services on time, bankers, or any other persons extending credit — want to know the ability of the business to pay its debts. Creditors must safeguard their own business existence.

Structure of Financial Statements

Balance Sheet. As previously stated, a balance sheet reveals the financial condition of a business on a specified date. It is a listing of all property owned by the business with all claims against it, the amount of debts, and the amount of investment by owners.

Suppose you (John Doe) bought a farm for $38,000 on Jaunary 1, 1960, and you valued the land at $20,000, the house at $10,000, and the machinery at $8,000. You made a down payment of $20,000 and gave the seller a mortgage for the remainder. Your financial statement would have these items:

John Doe
Balance Sheet — January 1, 1961

Assets		*Liabilities & Net Worth*	
House	$10,000	Mortgage owed (Liability)	$18,000
Land	20,000	Net Worth (Investment)	20,000
Machinery	8,000		
Total Assets	$38,000	Total Liabilities & Net Worth	$38,000

This is an example of a simple balance sheet, but even more complicated ones are similar. Many items may be shown under assets, but each is a property of the business. The balance sheet of the large business may include numerous liabilities, each a claim against the business. The net worth section always shows the money invested and claims of the owners against the business.

Marketing Association
Balance Sheet

December 31, 1961

ASSETS

1.)	**Current Assets**			
	Cash		91,800	
	Accounts receivable	$1,560,000		
	Less: allowance for bad debts	60,000	1,500,000	
	Inventory		1,360,000	
	Total Current Assets			$2,951,800
2.)	**Investments**			
	Other firms or securities			137,000
3.)	**Fixed Assets**		135,000	
	Land			
	Buildings	$5,200,000		
	Machinery and equipment	2,500,000		
	Automobiles and trucks	990,000		
	Furniture and fixtures	127,000		
	Total	$8,817,000		
	Less allowance for depreciation	3,225,000	5,592,000	
	Total Fixed Assets			5,727,000
4.)	**Other Assets**			
	Prepaid insurance			5,000
	Total Assets			8,820,800

LIABILITIES AND NET WORTH

5.)	**Current Liabilities**			
	Accounts payable — trade		$ 270,000	
	Accounts payable — producers		790,000	
	Notes payable		185,000	
	Mortgage payment due 3/1/60		50,000	
	Employees taxes witheld		38,700	
	Accrued payroll and payroll taxes		117,600	
	Total Current Liabilities			$1,451,800
6.)	**Fixed Liabilities**			
	Notes payable		$ 125,000	
	Mortgage payable		200,000	325,000
7.)	**Net Worth**			
	Capital Stock — Common		$1,695,500	
	— Preferred		4,998,500	
	Reserve for Contingencies		350,000	
	Total Net Worth			7,044,000
	Total Liabilities and Net Worth			8,820,800

The balance sheet on p. 4 is of a complex marketing firm. It is simply an expansion in details of the balance sheet on p. 3. The first section shows assets or property owned by the business. Assets are divided into these categories:

1.) **Current Assets.** These represent cash or items that can be converted into cash in a short period of time. Cash, accounts receivable (goods sold on credit), and inventory are usually found in this group. All accounts receivable may not be collected, so an allowance for bad debts is set up in order to place a true value on them.

2.) **Investments.** Most businesses have investments in other businesses or in securities like government bonds. These represent property and are shown as assets.

3.) **Fixed Assets.** These are assets of a permanent nature used in the operation of the business. All assets of this type (except land) depreciate as soon as they are put in use; so, over a period of years an allowance for depreciation of $3,225,000 has been charged against operations since the fixed assets were purchased.

4.) **Other Assets.** Prepaid items are current expenses paid in advance of the benefits received.

The second section of the balance sheet shows liabilities and net worth. Liabilities are debts owed by the business. They are placed under the following headings:

5.) **Current Liabilities.** These represent debts due in a short period of time — usually less than one year.

6.) **Fixed Liabilities.** These represent debts due after one year.

7.) **Net Worth.** Represents the equities of the owners. It is the investment or claims by the owners on the assets of the business. The net worth items shown are common and preferred stock and reserves. The reserve for contingencies represents funds set aside as a cushion against inherent risks of the business.

The Profit and Loss (Operating) Statement is another important financial statement. It shows the results of operations of a business over a given period of time. Our sample shows the condensed operating statement of a marketing firm for the year ended December 31, 1960.

To the management of a business the operating statement will show efficiencies and inefficiencies of operation. For most businesses the cost of goods sold

Marketing Association

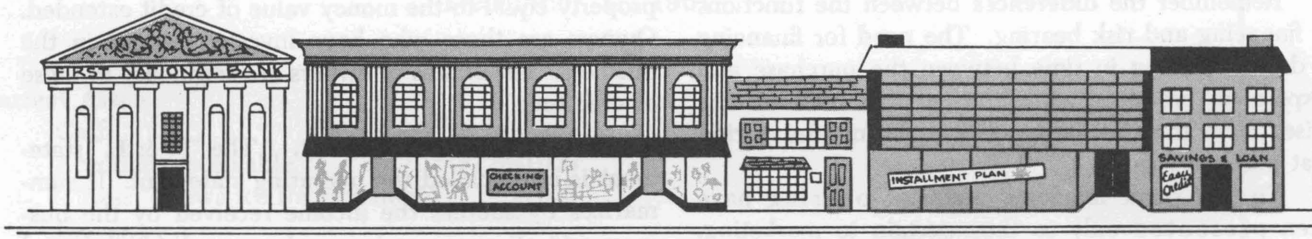
Operating Statement

Year Ending December 31, 1960

Income:		
Sales	$19,925,000	
Less: returns to producers	12,120,000	
Gross Profit		$ 7,805,000
Operating Expenses		
Salaries and wages	$ 3,525,000	
Supplies	650,000	
Depreciation	389,000	
Taxes and licenses	457,000	
Advertising	75,000	
Utilities	625,000	
Truck expense	540,000	
Bad debts	25,000	
Insurance and bonding	90,000	
Interest	365,000	
Miscellaneous	434,000	
Total Expenses		7,175,000
Net Profit		$ 630,000

is, by far, the largest item of expense. The difference between this figure and the amount for which goods were sold is very important. This sum must be large enough to cover expenses and realize a profit.

Analysis of Financial Statements. Two phases of financial statements have been discussed: use and structure. The third and most important phase is analysis and interpretation of financial statements. The relative changes that occur within a business from time to time, and how the changes compare with comparable business, must be studied. As the physician diagnoses the condition of a patient, a person qualified to analyze financial statements can reveal the weak and the strong points of the operations of a business.



Consumer Credit In Marketing

The type of credit needed to operate a marketing firm is known as producer's credit. Consumer credit, also called "buying on the installment plan" and "buying on time", lets the consumer have the use of goods while paying for them. Some could save and pay cash for the item but prefer to start enjoying it immediately.

There are some goods which depend heavily on various forms of consumer credit to facilitate marketing. For example, nearly every firm selling automobiles or household appliances must also be in position to aid in consumer financing.

The consumer who knows his way in marketing will get all the costs of a credit purchase and compare the total with the cash price. Financing charges differ, and a little comparison often can save money. Your personal marketing can be made more effective through use of good credit sense.

It is up to the consumer to figure the cost of using credit. The dollar cost is the easiest to figure. True interest rate is difficult to determine; however, it does give a better way to compare financing charges.

THE DOLLAR COST is the difference between the cash price of an item or amount of money received on a loan and the total amount paid to the firm or lender.

THE TRUE INTEREST RATE may be difficult to figure. When you borrow $100 at 6% and keep it all for a year, and then repay the lender $106, the $6 is a true interest rate.

If the $6 is deducted in advance, it is said to be discounted. The true rate is then higher as you have the use of only $94.

If the payments are made each month on the *total amount,* (including principal and interest), the true percentage rate is about twice the stated rate.

FORMULA TO FIGURE TRUE INTEREST RATE

$$\frac{\textbf{2 (carrying charge X number of payments in a year — 12 or 52)}}{\textbf{Amount of loan or balance due} \times \textbf{total number of payments + 1}} = \textbf{true interest rate}$$

EXAMPLE — Cash price of refrigerator $240.00

Using installment credit

Down payment	**$ 30**
12 monthly payments of $19 each	**228**
Total cost	**$258**
Less cash price	**240**
Financing charge	**$ 18**

Total cost	**$258**
Less down payment	**30**
Balance due	**$228**

Using formula to determine true interest rate —

$$\frac{2\ (\$18 \times 12)}{\$228 \times 13} = \frac{\$432}{\$2964} = \textbf{14.6\% true interest rate}$$

Consumer credit is an important device in marketing. The use of consumer finance has furthered the progress of industries. The question facing the consumer in the market place is not "Should credit be used?", but rather, "How can it be used wisely?"

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