CREDIT SALES

At some stage, you may be required to sell your goods on credit. This decision should not be made lightly. There are several matters for you to consider before you move into credit sales:

a. It is important to realise that if you provide credit, you are using your capital. Until your customer pays his debts, the money, which could have been used for buying other goods to make a profit, is tied up. You are, in fact, losing money.

b. It is necessary to check on the customer to see if he is trustworthy. There are several credit organisations which will do this credit check for you.

c. You must ask yourself, "How much is this going to affect my cash flow?" Too much credit can slow, or even stop the development of a business.

   If you decide that the business cannot carry credit sales, there are alternatives. You can become a trader member of a buy group company. You can apply to a bank to become a merchant member of the credit card system. These schemes are described below:

   Buy Group Systems

   Customer members pay a nominal fee to join, and if their credit ratings are acceptable, they are allowed to purchase from member merchants. The organisation negotiates discounts with members. These discounts are paid to the customer members as a discount once a year. Merchant members get free advertising in the organisation's handbook and the organisation recommends that members make use of these organisations.

   From the customers point of view, this provides approximately a month's credit and it usually brings a bonus just before Christmas. The merchant has to provide a small discount, which he would normally have given for a cash purchase anyway. Customers are attracted to his business because they can get credit – they might even by-pass competitive shops to obtain this credit!

Credit Cards

Introduced in the 1960's, the credit card system is now well established. It is designed to replace the use of cash or cheques in consumer purchases or transactions. Shopping with credit cards is safe and convenient. As with the cheque, the credit card transaction has three parties:

- The bank or financial institution who issues the credit card to a person whose credit worthiness has been checked.

- The credit card holder who has been issued with a credit card from a bank or financial institution after the necessary formalities have been completed. This institution then irrevocably agrees to pay the supplier of goods or services which have been purchased with one of these cards.

- The supplier who recovers the value of the goods from the bank or financial institution purchased with the card.

The credit card advantages to the seller are:

- He receives cash for the goods he sells, instead of having to wait until the end of the credit period.

- He saves the cost of keeping many ledger accounts, credit control and debt collection.

- Credit cards lead to impulse buying and therefore increase turnover.

- The system may attract visitors, who are credit card holders without hard cash, from other parts of the country to his shop, or even from abroad.

- He reduces his bad risk debt, because the issuing bank guarantees payment.

- He reduces the need for working capital, thus helping the cash flow.

- An increase in liquidity may enable him to pay his creditors promptly and so obtain extra discounts.

- The accelerated cash flow may reduce the need for an overdraft and the payment of interest.

These advantages are most likely to offset the small service charges made by the bank or financial institution to the seller for the collection of the money due and for the guarantee that the debt will be paid. The credit card also has advantages for buyers:

- It is easier to make purchases without the need to carry cash.

- He saves the cost of bank charges and cheques by removing the need for a current bank account.

- Meeting travelling expenses easily without having to carry a great deal of cash is a great benefit to the buyer. This can be extended to overseas countries by means of exchange agreements which provide for an international credit card structure.

Some financial institutions combine a deposit account with a credit card service. When the depositors account is in credit, he earns interest on the daily balance and this interest is paid monthly.

THE INCOME/EXPENDITURE STATEMENT

This statement shows if a profit or a loss has been made over a period. This is usually over a period of twelve months, but the small businessman should make these statements regularly, preferably monthly. This enables him to keep a tight hold on the business because he can see any changes or faults that occur in time to correct them. In other words the income/expenditure statement is a summary of income and expenditure items.

Income is the total of all sales for the period under question. It includes both cash and credit sales. Even if you take goods from your own business, you must add the value of the goods you have taken to the income.

To get sales, goods have to be purchased. The costs of these purchases are deducted from the sales income. This gives you your gross profit. Assume sales of £10,000 and purchases of £4,000:

SALES	→	£10,000.00
PURCHASES	→	£4,000.00
GROSS PROFIT	=	Sales – Purchases
	=	£6,000.00

It is, however, likely that all the goods that were bought were not sold, and therefore, remained in stock. The table below shows how to calculate gross profit in such a case:

SALES	→	£6,500.00
PURCHASES	→	£4,000.00
GROSS PROFIT	=	Sales-purchases-stock
		£1,000.00

Note that stock is always valued at cost price. If all the goods were not sold, the gross profit for the next period with sales at £7,000.00, purchases at £4,000.00, opening stock £1,500.00 and closing stock £1,000.00, would look like this:

SALES	→	£7,000.00
PURCHASES	→	£4,000.00
OPENING STOCK	→	£1,500.00
CLOSING STOCK	→	£1,000.00
GROSS PROFIT	=	£2,500.00

To reach a net profit figure, fixed expenses are deducted from gross profit.

The table below shows a simple income/expenditure statement. This is the type that will help you to run your business. When a loan is obtained from a bank or financial institution, mentors are assigned to visit the business periodically to help you with the management of the business. The statement below is set out in a style they would like to see:

Example:

A business has monthly sales of £29,000. The cost of the purchases is £14,000. Fixed expenses are as follows:

- Electricity £500.00
- Water £100.00
- Telephone £300.00
- Transport £500.00
- Wages & salaries £4,500.00
- Rent £1,000.00
- Rates £200.00
- Office Stationery £100.00
- Cleaning £500.00
- Loan Repayments £300.00

Calculating the gross profit, the fixed expenses, the net profit:

ITEM	EXPENDITURE	ITEM	INCOME
ELECTRICITY	£500.00	SALES	£29,000.00
WATER	£100.00	COST OF SALES	£14,000.00
TELEPHONE	£300.00	GROSS PROFIT	£15,000.00
SALARIES	£4,500.00	FIXED EXPENSES	£8,000.00
RENT	£1,000.00	NET PROFIT	£7,000.00
RATES	£200.00		
STATIONERY	£100.00		
CLEANING	£500.00		
LOAN REPAYMENTS	£300.00		
TRANSPORT	£500.00		
TOTAL EXPENSES	£8,000.00		

THE BALANCE SHEET

While the income/expenditure statement is a statement of business transactions over a period, the balance sheet shows the financial state of a business at a specific time. It shows what a business owes, and how much is owed to the business. That which the business owes are called liabilities and what it owns are called assets. The balance sheet also shows what the business is worth.