THE LANGUAGE OF BUSINESS

FARM CREDIT KNOWLEDGE CENTER

The Language of Business

- There are terms specific to the business world
  - *Like learning a new language*
- You should understand these terms:
  - *To improve your business management*
  - *To be able to talk with:*
    - Lenders
    - Accountants
    - Consultants
    - Lawyers
    - Other business owners/managers

Understanding Profits

- Most businesses try to earn profits
  - *Profits allow them to:*
    - Invest in the company
      - *Buy new equipment, expand, replace old equipment*
    - Pay the owners
- Profits = the money left after paying all expenses
  - *Profits = Revenues - Expenses*

Profits

- Revenues
  - *The money coming in (income) from selling your product or service*
  - *Revenues = Selling Price/Unit x Units Sold*
    - For all products/services sold
  - *Revenue refers to the money coming in*
    - It does NOT include any expenses

Profits

- Expenses = cost of doing business
- 2 Main Types of Expenses:
  - *Variable Expenses (Operating Expenses)*
    - These are expenses that change directly with the level of production
      - *If you increase production, these costs increase*
      - *If you decrease production, these costs decrease*
    - Easy to think of "out of pocket" expenses
    - Also called "Cost of Goods Sold"
    - Examples:
      - *Fuel, fertilizer, seed, chemicals, hired labor, repairs*

Profits

- *Overhead (Fixed) Expenses*
  - These are costs that you have just because you are in business
    - *Business licenses, property taxes*
    - *Office rent, insurance premiums*
    - *Administrative and office expenses, interest on loans*
    - *Depreciation*
    - *Owners salary (not always included in overhead)*
  - These costs do NOT change significantly if production changes
    - *If production increases, office rent doesn't change*

Profits

- Total Expenses = Variable Exp. + Overhead
  - *Measure of the total cost of doing business*
- Gross Margin = Revenues – Variable Expenses
  - *You want your gross margin to be greater than $0*
- Gross Margin/Unit = Gross Margin divided by the number of units sold
  - *Good number to know*
  - *It shows which products are earning you the most*

Profits

- Total Profit = Revenues – Total Expenses
  - *Or: Profit = Gross Margin – Overhead Expenses*
  - *Also called "net income"*
  - *You want Profit to be greater than $0*
    - The higher the better (usually)!
  - *When a manager talks about "the bottom line", they are referring to profits*

Capital Structure

- Capital = resources that a business owns
  - *Land, buildings, equipment, labor, cash*
  - *A "capital purchase" refers to buying something that will be used in the business year after year*
    - Tractors, breeding livestock, barns, mowers

Capital Structure

- Asset = something tangible that a business owns or controls
  - *Land, buildings, equipment, cash, inventories*
  - *Breeding livestock, feeder livestock, fencing*
  - *Accounts receivable*
    - This refers to money owed to a producer for items sold "on credit" or "on account"
    - Example: A customer buys $5,000 of lumber on credit and will be billed at the end of the month.
      - *The $5,000 is called "accounts receivable" for the seller*

Capital Structure

- Liabilities = something the business owes to a lender or creditor
  - *Accounts Payable = money owed to a supplier for items purchased on credit*
    - You will pay the supplier at the end of the month
  - *Loans = more formal arrangement than Acct. Payable*
    - Loans are used to purchase high-dollar assets
    - Apply to a lender for a loan
    - Lender provides you with funds for your stated purchase
    - You repay the lender over time
      - *Terms are specified in the loan contract*

Capital Structure

- Owners Equity (or Net Worth)
  - *Equity = the difference between market value of an asset and the remaining loan balance*
  - *Equity = Value of Assets – Remaining Loan*
  - *You want your equity to be greater than $0*
  - *You want your equity to grow over time*
    - This means you are:
      - *Earning profits*
      - *Paying down your liabilities*
      - *The value of your business is growing*