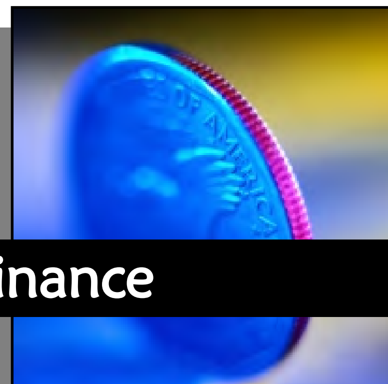
Preliminary Reading



Bottom-Line Finance

pci global inc.
technology driven leadership development

Background

In the 21st Century business environment with the presence of intense global competition, time pressures and cost consciousness, a key focus has to be on profitability. Everyone in management needs to learn the basics of finance; the language of business. Every investor, in publicly traded companies, needs to know their company's reported income and expenses. As managers go up the organizational ladder they must learn how the decisions they make materially influence corporate profitability.

Bottom-Line Finance
Running a Business - A Computer Simulation

PCI Global's Bottom-Line Finance features a computer simulation of a basic business. In other finance workshops, participants decompose a pre-prepared set of financial statements in order to better understand them. This process assumes participants will remember where each item comes from and how each business decision goes into making up each line of each financial statement. In this workshop, by contrast, you will <u>build up</u> each financial report line-by-line, decision-by-decision. You will also be able to see the result of each business decision you make immediately, in a test spreadsheet and in a graphical form (especially created for you) only available in this simulation.

Working alone or in a team of two to four other managers, you will start with blank forms making basic business decisions. With each decision you will update a complete set of basic financial reports and in the process you come to understand them in a way that no other learning method can deliver. We call this layered <u>learning by doing</u> (you build up another layer of understanding with each decision).

Overview: Business Decisions

For your simulated company (details below), you will have to raise capital, borrow funds and then respond to potential customer requests for a price quotation. You set prices on orders in a tightly competitive market, order equipment and materials, hire staff, pay bills and taxes and start up a new business to produce goods or services.

You or your business team will make a number of decisions over the six simulated months and then you will enter them into your computer. Your personal computer will simultaneously: (1) analyze your decisions with <u>immediate feedback</u> on results and (2) update each account in all three key financial reports.

From a business perspective, you discover how effective your decisions were, how many orders you received, if you have positive cash flow and most importantly if you are making or losing money.

Shareholder Value and Profitability

From a finance perspective you see every report updated as soon as you make each decision – to borrow, to spend, to invoice – impacts each report. From these interactions you will discover what drives shareholder value and profitability. Without realizing it, the language of business rises in your consciousness.

Integration of Business Decision Making with Finance

There are six decision making periods in the simulation with multiple decisions to be made in each time. Each period (a month) focuses on different areas of Finance: (1) Capitalize and fund the company (2) Begin to operate the business (3) Analyze cash flow of business (4-5) Execute strategy, Break Even Analysis and Forecasting and (6) Analyze the Business – Performance Metrics. In each period, you make decisions suitable for that stage of your business's development and complete a financial analysis on an increasingly sophisticated level. After each period you get feedback on (a) how much business your team did and (b) your businesses profitability, financial strength and utilization of assets.

Period I

Decisions: Establish the Business

- Investors' Capital
- Borrow Money - short term/ long term
- Bids and Product Pricing
- Acquire the means of production (workstations and staffing)
- Acquire Materials from the Supply Chain

Financial Analysis - Balance Sheet

- Calculate investment and start up spending
- Calculating Selling, General and Administrative Expenses ("SG&A")
- Allocate portion of overhead
- Pay Interest and Principle

Period II

Decisions: Begin to Operate the Business

- Analysis of Supply Chain
- Orders Received
- Analysis of Capacity
- Analysis of Workforce
- Bids and Product Pricing
- Production
- Sales
- Purchase Materials
- Meeting Financial Obligations

Financial Analysis - Income Statement

- Understanding Revenue Recognition
- Understanding the Cost of Goods Sold
- Selling, General and Administrative Expenses
- Allocating Portion of Overhead to Inventory
- Pay Interest and Principal
- Record Depreciation
- Pay Taxes

Period III through V

Decisions: Continuing Operations

- All the same as in Period II, plus;
    - Issue and account for service contracts
    - Collect Accounts Receivable

Financial Analysis - Statement of Cash Flow

- All the same as Period II plus;
    - Interest and Selling, General and Administrative
    - Market analysis and forecasting

Period VI

In Period VI, we finish making business decisions and begin **Analyzing the Business with Ratios and Other Tools**. This is the culmination of Bottom-Line Finance in which *all the decisions you made for this start up business are analyzed* while you apply the Key Financial Ratios you have learned.

These ratios include:

Analysis of Profitability

- Gross Profit Margin
- Contribution Margin
- Net Profit Margin

Financial Strength

- Current Ratio
- Quick Ratio ("Acid Test" Ratio)
- Debt to Equity Ratio

Utilization of Assets

- Return on Assets (ROA)
- Return on Investment (ROI)
- Inventory and Accounts Receivable Turnover

Pre-requisites
No previous knowledge or training in Finance or Accounting is required for success in this course. Some business management experience is needed.

The Case Study
Background
As a result of your track record to date, you have been appointed to start up a new business for the company. We have acquired the rights to a new product that is lighter, more powerful and less costly to prepare than our existing products. Rather than hurt our existing business in this line, it has been decided to set this new product up as its own company, even to compete with us. The board felt the new business stood a better chance of survival outside of the larger enterprise. If it is successful, then it will be integrated into the larger enterprise.

You will be working in a team of two to three other managers to establish the business, obtain financing, respond to orders and build and ship products.

Financial Orientation
You will have to raise capital, borrow money, respond to requests for quotations from commercial and governmental customers, acquire the means for production and materials from the supply chain, and staff up. You will have to manage finances, make business decisions, meet financial obligations, and decide on customer service. Most importantly, you will have to prepare basic financial reports each period as you drive this new business to revenue growth and profitability.

Raising Capital
Your parent company is willing to fund an initial capital infusion of up to $600,000. They expect a return commensurate with the parent company's financial results.

Borrow Long Term:
1. The interest rate is 8%
2. The length of the loan is five years
3. Principal and interest loan payments begin at the end of the month the loan is borrowed
4. The loan is limited to 50% of Initial Capitalization
5. You can borrow long term only during the first period

Borrow Short-Term
1. The interest rate is 13%.
2. If you completely run out of cash you will be charged an extra 5%
3. The length of the loan is 90 days
4. Interest is paid monthly in cash, principal is paid after 90 days

Sales & Pricing

A system is a unit of sale for the product each unit is a system. There is already an RFP (Request for Proposal) for one hundred eighty new systems. There are two other competitors for this product. The competitive price (standard or industry price) for this product is $7,500/system. If you bid that price, you will receive one third of the possible orders. If you bid higher you will not get as many orders; if you bid lower you will get more of the orders but may lose money on the deal. The market will change each successive month and you may change your prices each month (prospectively). You will need to build and ship the systems orders received in the next month. Payment terms are net 30 days. If you are not able to ship all of the orders you receive, backorders will be created which will be priority shipped in the following month with a 10% price reduction penalty for making your customers wait for the systems.

Operations

To build the new systems you need machines (workstations), materials (parts) and associates (operators). The costs, terms (if any) and lead-time for each:

- Workstations: Cost: $100,000 each. A 50% deposit is payable on order (your credit is not that good yet). It takes one full period to arrive, be set up and start producing. Capacity: 40 systems/workstation per period. Balance due next period (after delivery).
- Materials: Production requires ten (10) sets of materials and parts (components) to build each system. Each set costs $650. There is no competitive bidding. There are no volume discounts. Payment is due in full in the following month. Each period, you must purchase the materials you will need for next period's production.
- Operators: You need one operator for each workstation. Operators earn $60,000 per year. This includes salary and benefits and is paid monthly. You cannot hire temps or part timers and you cannot terminate Operators once they are hired.
- Selling, General and Administrative Costs: You also have to pay before you even start selling:
  - Rent at $10,000 per period
  - Management and Administrative Salaries – Manager, Bookkeeper and Administrative Assistant - $19,000 per period
  - Utilities: $4,000 per period - Electricity, water, phone, FAX, Email
  - Other miscellaneous costs - Insurance, maintenance, cleaning etc. - $4,000 per period

Service Contract

Starting in period 2, you will be able to offer buyers of your systems a service contract. Half of all customers will take the contract if offered. The price for the contract is set at $2,400 per year per system. The contract is invoiced for each covered system when the unit is shipped. You will begin recognizing revenues, at the rate of $200/system/month, one period after shipment.

End of Case

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