**Economics summary chapter 4 balancing the books**

**Section 1. Setting up a business.**

Most entrepreneurs do not have enough money to start up their own company. They need to borrow money from the bank to convince the bank they will be able to repay the loan and interest in the future some financial overviews are necessary. Before you can begin, you need to make an ***investment budget***: an overview of the expected expenditure to start a business. On an investment budget you can find: ***inventory, goods in stock, bank balance and money in the cash register***. The investment budget ends with the ***total investment***: the total value of all assets of the business before it starts to operate. To get a loan from the bank not only an investment budget is needed, but also a ***profit and loss budget***: an overview of all expected costs and revenue. For the profit and loss budget the ***turnover excluding vat*** is needed.

Turnover – cost of sales = gross profit

Gross profit – operating costs = net profit

The ***cost of sales*** is the amount that the entrepreneur originally paid for the products he has sold in a specific period. The ***operating costs*** are costs of business other than the cost of sales. ***Depreciation charges*** are the costs of the decrease in the value of **fixed** capital goods. The ***financing plan*** explains how the company gets the money it needs to start its business. The financing plan ends with the ***total borrowing requirement***: it shows the total amount of money that is needed to buy all assets of the investment budget of the company. ***Owner’s equity*** is the amount of money that the owner has invested in his company. ***Debt capita***l has been borrowed by the owner from others. When a company makes a profit, this amount belongs to the owner of that company. So making a profit causes an increase in the owner’s equity

Owner’s equity = total capital – debt capital

**Section 2. Assets and debts.**

A balance sheet gives an overview of the assets and liabilities of a company at a specific point in time. The assets of company are their possessions. Assets can be split up intro 3 categories:

* ***Fixed assets***, fixed assets last for more than one production or one year. (e.g. premises, van, inventory)
* ***Current assets***, current assets only last for one production or less than one year. (e.g. goods in stock, debtors)
* ***Liquid assets***, liquid assets can be used by the company to pay with. (e.g. cash, bank balance)

The liabilities consist of the debts of a company and the equity. So, liabilities show how the total assets are financed, where did the company gets its money from. Liabilities can also be split up into 3 categories.

* ***Equity***, equity is the value of a company after the debt capital has been subtracted from the total assets.
* ***Long-term debts***, long-term debts run for more than one year, so it will take more than one year to repay all these debts. (e.g. mortgage loan)
* ***Short-term debts***, short-term debts run for less than one year, so they must be repaid within one year. (e.g. creditors, tax to be paid, bank balance)

The equity component brings a balance sheet into true balance.

Value total assets = value total liabilities

**Section 3. Revenue and costs.**

A ***profit and loss account*** gives an overview of the revenue, costs and profit during the past year. On the balance sheet the component equity is always on the **credit** side. Turnover is on the credit side of the profit and loss account because it has a **positive** effect on equity. Costs are on the debit side of the profit and loss account because they have a **negative** effect on equity.

When total revenue > total costs, equity has increased, which equals the net profit.

When total revenue < total costs, equity has decreased, which equals the net loss.

**Section 5. From balance sheet to balance sheet.**

Changes in the balance sheet are caused by financial transactions of the company. The balance sheet continues to be in balance after each financial transaction that has been processed. If something is bought on account, it means that suppliers allow you to pay the invoice after several weeks/months after you bought the goods. Financial transactions of the company always cause changes in the balance sheet. Some financial transactions also cause changes in the profit and loss account of the company. All costs have to be booked on the debit side of the profit and loss account.

Equity January 1st + net profit + private deposits – private withdrawals = equity December 31st

A private withdrawal leads to a decrease in the balance component equity. A private deposit leads to an increase in the balance component equity.