PERSONNEL NOTEBOOK

For Your Most Important Resource — The Human Resource

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The Skills of Top Managers

Part IX

In Parts I through VIII of this subject, we reviewed the first 13 of what *Harvard Business Review* (HBR) identifies as the 13 skills that set top managers apart from others. Those 13 skills were**:**

1. **Setting Goals That Inspire Others**
2. **Hiring the Best**
3. **Keeping the Best**
4. **Delegating With Confidence**
5. **Managing Your Time**
6. **Managing Teams**
7. **Appraising and Coaching**
8. **Handling Problem Employees**
9. **Dealing With Crisis**
10. **Developing Your Career**
11. **Becoming a Leader**
12. **Strategy**
13. **Mastering Financial Tools**

We began number 13, Mastering Financial Tools, with the budgeting process and continued into preparing the Master Budget and Understanding Financial Statements.

In this, part IX, we will continue with Financial Tools and Understanding Financial Statements. In this issue we will focus on Reading the Income Statement and the Cash Flow Statement.

How to Read the Income Statement

The Income Statement is the financial document that tells you the results of your operations over an extended period of time. Unlike the Balance Sheet, which is a snapshot of your company's operations at one particular point in time (today), the Income Statement shows your company's results over the past month, quarter, or year.

It tells you whether the company is making a profit or not. That's why it's often referred to as the Profit and Loss statement or the P&L. Included in the information it conveys is how much money the company made or lost, how much money was spent to make that profit (or loss), and how much is left.

The contents of the Income Statement can be expressed as an equation:

Revenues − expenses = net income (or net loss)

What you'll find in the Income Statement

1. **Sales Revenue.** Often called the “top line,” this represents the amount the company has sold during the period in question. When there is more than one line of revenue shown above the Total Sales Revenue, it provides detail as to which products or services are major revenue producers

2. **Sales Costs.** This is what it costs the company to generate the sales shown in the total Sales Revenue above. Compare the total costs to the total revenue, but also look at the cost of each line of product or service versus its revenue. Sales Costs is also known as Cost of Goods Sold.

3. **Gross Profit (or loss).** This is the difference between Sales Revenue and Sales Costs. If the difference is positive, it’s a profit. A negative difference is a loss and is shown in (brackets).

4. **General and Administrative (G&A) Expenses.** These are costs associated with running the company as opposed to the costs of making or buying the products (see Sales Costs above). These costs should be monitored closely and kept as low as possible.

5. **Sales and Marketing Expenses.** These are other costs not directly related to manufacturing the product or providing the services. While certainly necessary, sales and marketing costs should be monitored and compared frequently to similar numbers from other companies in the same industry with products in the same point in the life cycle.

6. **Research and Development (R&D) Expenses.** This is the part of its income the company is reinvesting in the business to find and develop new products and/or to improve existing products. This is an indication of how much management values innovation. Look at whether it is increasing or decreasing each year.

7. **Operating Income.** This is what’s left when you subtract all the operating expenses from the Gross Profit.

8. **Income Before Taxes.** After subtracting any interest paid on the outstanding debt from Total Operating Income you are left with Income Before Taxes. This is the amount on which the company expects to pay taxes.

9. **Taxes.** This is the amount the company has paid or expects to pay in taxes for the period. It includes all taxes to all jurisdictions.

10. **Net Income From Continuing Operations.** After subtracting taxes from its income, this is what the company has left. You might think of this as the company’s take-home pay.

11. **Profit Margin.** This varies from industry to industry, but it’s a good measure to compare similar companies from either an investment or a benchmarking perspective. It’s like the interest rate you get on your investment. Try to compare your Profit Margin to companies offering the same products or services that your company offers.

12. **Nonrecurring Events.** This is the cost of any one-time expenses, for instance, restructuring the business, a major layoff, or an unreimbursed

causality loss. These are shown on a separate line so as not to confuse the continuing operations in number.

13. **Net Income.** This is what the company has left after subtracting all its expenses from its total revenue. If the difference is positive, it is profit. A negative difference is a loss and is shown in (brackets). For a company to remain healthy and in business, this number needs to be positive more often than it's negative.

14. **Dividends to Shareholders.** Companies pay dividends to the shareholders who own the business. If any dividends have been paid during the period being reported, they are shown on this line. These can be to the common stockholders, preferred stockholders, or other investors depending on the company. Dividends are usually paid out only once a year.

15. **Net Income Available to Shareholders.** This is "the bottom line," the money the company has left at the end of the period. It is held for future needs, invested as the Board of Directors determines, or returned to investors in the future.

Reading The Cash Flow Statement.

The Cash Flow Statement, the last of the three essential financial statements (The Balance Sheet, The Income Statement and The Cash Flow Statement), is the least used and least understood. Many people think of it as profit. But profit may or may not contribute positively to cash flow. Cash flow is the money you have available to pay for the operations and spending. Profit is what's left over after all the operations and spending is done.

Like your bank statement, it tells you how much money was on hand at the beginning of the period and how much was left at the end of the period. It then describes how the company acquired that money and how it spent it. It shows all expenditures as negative (bracketed) figures and all sources of money as positive figures.

If you're a manager in a large corporation, you typically will not have much need of the cash flow information on a day-to-day basis. If, however, you're a manger in a small company, you're probably keenly aware of your cash flow situation every day. It tells you whether you can purchase supplies, pay vendors, and make payroll.

When cash flow is tight, you will probably want to be conservative with expenditures and investments. Alternatively, if you're flush with cash, you may have many opportunities to make new investments and to avoid heavy interest costs. The Cash Flow Statement tells you whether your company is turning your accounts receivable into cash. That ability is ultimately what will keep your company solvent. Solvency is the ability to pay your bills as they become due.

What you'll find in the Cash Flow Statement

The Cash Flow Statement identifies cash income (receipts) and cash outgo (payments) that were produced by investing activities, financing activities, and operating activities.

- **Investing Activities** include the (1) receipts from the sales of equity and debt securities of other companies and (2) amounts received from the sale of fixed assets. Cash outflows for investing activities include (1) payments to buy equity or debt securities of other companies and (2) payments to buy fixed assets.

- **Financing Activities** include the issuance of stock and the reacquisition of previously issued shares as well as the payment of dividends to stockholders. Also included are debt financing and repayment. Cash inflows from financing activities are composed of funds received from the sale of stock and the incurrence of debt. Cash outflows for financing activities include (1) paying off debt, (2) repurchasing of stock, and (3) issuing dividend payments.
- **Operating Activities** are connected to the manufacturing and sale of goods or services. Cash inflows from operating activities include (1) cash sales or collections on receivables arising from the sale of merchandise or services and (2) cash receipts from debt securities (interest or income) or equity securities (divided income) of other entities. Cash outflows for operating activities include (1) cash paid for raw material or merchandise intended for resale, (2) payments on accounts payable from purchases, (3) payments to suppliers of operating expenses (office supplies, advertising, insurance, and (4) wages.

Summing up

The Balance Sheet shows a company's financial position at a specific point in time. It gives a snapshot of the company's financial situation, its assets, equity, and liabilities <u>on a given day</u>.

The Income Statement shows the bottom line; it indicates how much profit or loss was generated <u>over a given period a month, quarter, or a year.</u>

The Cash Flow Statement tells where the company's cash came from and where it went. In other words, the flow of cash in, through, and out of the company

In part X, the final installment, we will review and summarize the skills of top managers.

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