LEC 31- 33

Business Plan - 20MS2007

How the business is to be financed?

- Long term own fund
  - Share Capital
  - Retained Earnings
  - Sale & Buyback Lease
  - Business Angel
- Long term debt fund
  - Bank long term loan
  - Debenture (a fixed interest)
  - Bonds
  - Venture Capital
- Short term fund
  - Overdraft
  - Working capital Loan
  - Gaining credit period from suppliers
  - Money Market Instruments

Share Capital

- Share capital is a company's amount of money legally raised through the sale of shares, and it includes both common and preferred stocks.
- In most cases, the share capital is increased through additional public offerings.
- A company can raise more money by making more stock available, but its authorized share capital is the maximum amount it can raise in a public offering.
- The proceeds from these sales are listed as "additional paid-in capital."
- This amount indicates the real price paid for the stock.

Retained earnings

- Retained Earnings (RE) are the accumulated portion of a business's profits that are not distributed as dividends to shareholders but instead are reserved for reinvestment back into the business.
- Normally, these funds are used for
  - working capital and fixed asset purchases (capital expenditures) or
  - allotted for paying off debt obligations.
- The RE formula is as follows:
  - **RE = Beginning Period RE + Net Income/Loss – Cash Dividends – Stock Dividends**
- Where RE = Retained Earnings

***Note: Dividend** - A portion of a company's profit paid to shareholders*

Sale & Lease Back is an alternative to traditional bank financing (investment loans, real estate loans). The entrepreneur sells an asset owned by the company, such as a machine or real estate, to a leasing company. This can be either an existing fixed asset or a new investment. After the sale, the enterprise leases the asset back for a fixed rental period and pays a fixed regular rent. The proceeds of the sale increase liquidity for the company which can be used for the general corporate purposes such as working capital, capex, R&D and acquisitions.

Sale & Buyback Lease

Business Angels

Investor angels, or business angels, are people who invest their money in the initial phase of startups, in exchange for participation in capital.

They also usually carry out the role of a mentor and offer their consent and experience to entrepreneurs.

Over Draft

An overdraft is a short-term line of credit granted by a bank to an account holder when checks presented against the account exceed the amount of cash available in the account.

An account usually has to be designated as having overdraft protection before this feature will be operable.

The amount of an overdraft is usually capped at an overdraft limit so that account holders will not abuse the privilege.

This service keeps account holder checks from bouncing.

The interest charges and transaction fees charged for overdrafts generate significant profits for banks.

However, when faced with excessive usage and the prospect of not being paid back by an account holder, a bank may unilaterally cancel overdraft protection.

Working Capital Loan

- A working capital loan is a loan that is taken to finance a company's everyday operations.

- These loans are not used to buy long-term assets or investments and are, instead, used to provide the working capital that covers a company's short-term operational needs.

- Those needs can include costs such as payroll, rent, and debt payments.

- In this way, **working capital loans are simply corporate debt borrowings that are used by a company to finance its daily operations**.

Credit Period

Customers are given a specified amount of time to pay an invoice, known as the credit period.

The concept shows how much working capital a business is ready to invest in accounts receivable to produce sales.

Therefore, greater investment in receivables is necessary to support a longer credit period

Money Market Instruments

- Money market instruments are securities that provide businesses, banks, and the government with large amounts of low-cost capital for a short time.
- The period is overnight or a few days, weeks, or even months, but always less than a year.
- The financial markets meet longer-term cash needs.

Long Term Bank Loan

- Long-term loans are those which have a more extended repayment period that can vary from 3 to 30 years.
- It can fulfill various financial requirements such as buying a house, renovating, pursuing higher education, buying a vehicle, starting a business, or even funding a vacation.
- The minimum tenure of such loans is three years.
- These usually have lower interest rates as money is borrowed for a more extended amount of time, except in the cases of personal loans.
- Most of the long-term goals are designed so that the recipient can pay the due amount prematurely against some fixed interest.

Characteristics - Long Term Bank Loan

- *The loan amount is usually large*
- *The interest rates for such loans are generally low*
- *Such loans are often associated with the collateral*
- *Exemption from taxes*

Debenture (a fixed interest)

- A debenture is a type of bond or another debt instrument that is unsecured by collateral.
- Since debentures have no collateral backing, they must rely on the creditworthiness and reputation of the issuer for support.
- Both corporations and governments frequently issue debentures to raise capital or funds.

Bonds

- A bond is a fixed-income instrument that represents a loan made by an investor to a borrower (typically corporate or governmental).
- A bond could be thought of as an I.O.U. (I owe you) between the lender and borrower which includes the details of the loan and its payments.
- Bonds are used by companies, municipalities, states, and sovereign governments to finance projects and operations.
- Owners of bonds are debtholders, or creditors, of the issuer.

- Bond details include the **end date** when the principal of the loan is due to be paid to the bond owner and usually include the **terms for variable or fixed interest payments** made by the borrower.

Venture Capital

- Entrepreneurs need investments for their start-up companies.
- The investments or the capital that these entrepreneurs receive from wealthy investors is called Venture Capital and the investors are called Venture Capitalists.
- VC firms reduce the risk of investments by co-investing with other VC firms.
- Usually, there will be the main investor called the ‘lead investor’ and other investors will be called ‘followers’.

How does venture capital fund work

1. Venture Capital Fund is made up of investments from wealthy individuals or companies who give their money to a VC firm to manage their investment portfolios for them and to invest in high-risk start-ups in exchange for equity.
2. The basic idea is to invest in a company's balance sheet and infrastructure.
3. Venture Capitalist nurtures the idea of an entrepreneur for a short period of time and exits with the help of an investment banker.
4. In a startup company, VC will receive an **equity partnership** in exchange for investments in the start-up company.
5. VC's receive liquidation preference, it means in the worst-case scenario where the company fails, VCs are given the first claim to all the company's assets and technology. It also offers voting rights over key decisions like Initial Public Offer (IPO) or even sale of the company.

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Projected financial statement for three to five years as per requirement.

- Successful companies plan ahead, looking as best they can into the near and distant future to chart a course to growth, innovation, and competitive strength.
- Financial projections, both as part of an initial business plan and as part of
  ongoing business planning, use a company’s financial statements to help business owners forecast their upcoming expenses and revenue in a strategically useful way.
- Most businesses use **two types of financial projections**:
  - Short-term projections
  - Long-term projections

Short-term projections

- **Short-term projections** are broken down by month and generally cover the coming 12 months.
- They provide a guide company can use to monitor and adjust their financial activity to set and hit targets for the financial year.
- In the first year, short-term projections will be entirely estimated, but in subsequent years, historical data can be used to help fine-tune them for greater accuracy and strategic utility.

Long-term projections

- **Long-term projections** are focused on the coming three to five years and are generally used to secure investment (both initial and ongoing), provide a strategic roadmap for the company's growth, or both.

Financial Projections: Core Components

- **Income statements**, sometimes called profit and loss statements, provide detailed information on your company's revenue and expenses for a given period (e.g., a quarter, year, or multi-year period).
- **Cash flow statements** provide a comprehensive view of cash flowing into and out of a business. They record all cash flow from operations, investment, and financing activities.
- **Balance sheets** are used to showcase a company's assets, liabilities, and owner's equity for a specific period.

How to Create Financial Projections

- The process of creating financial projections is the same whether you're drafting a business plan or creating forecasts for an existing business. The primary difference is whether you'll draw on your own research and expertise (a new business or startup business) or use historical data (existing businesses).
- Start with a Sales Projection
- Cash Flow Statement
- The Balance Sheet

Start with a Sales Projection

- A sales forecast is the first step in creating your income statement.
- You can start with a one, three, or five-year projection

Profit/Loss	Year One	Year Two	Year Three	Year Four	Year Five
Sales	$4,723,047	$5,184,298	$5,675,431	$6,123,984	$6,593,380
COGS	$3,307,023	$3,630,046	$4,063,937	$4,288,014	$4,616,685
Gross Margin	**$1,416,024**	**$1,554,252**	**$1,701,494**	**$1,835,970**	**$1,976,695**
G. Margin (%)	29.98%	29.98%	29.98%	29.98%	29.98%
Operating Expenses					
Wages	$400,000	$420,000	$442,000	$463,000	$485,000
Taxes/Benefits	$137,021	$142,570	$150,874	$159,021	$164,997
Marketing	$35,000	$40,500	$42,750	$46,875	$51,974
Rent	$135,000	$137,000	$139,000	$141,000	$143,000
Utilities	$37,000	$38,475	$39,543	$40,485	$41,993
Depreciation	$50,000	$50,000	$50,000	$50,000	$50,000

Cost of goods sold

COGS = **Beginning inventory + purchases + Freight In – Ending inventory – Purchase Discounts – Purchase Returns and Allowances.**

Professional, Merchant, and Administrative Fees	$110,435	$129,854	$144,347	$160,852	$173,031
Other	$101,299	$117,043	$133,971	$145,256	$155,307
TOTAL OPERATING EXPENSES:	**$1,005,755**	**$1,075,442**	**$1,142,485**	**$1,206,489**	**$1,265,302**
Operating Profit	$410,269	$478,810	$559,009	$629,481	$711,393
Interest	$0	$0	$0	$0	$0
Taxes	$16,783	$42,976	$67,125	$84,963	$97,224
Net Profit	**$393,486**	**$435,834**	**$491,884**	**$544,518**	**$614,169**
Net Margin (%)	8.33%	8.41%	8.67%	8.89%	9.31%

Cash Flow Statement

- Tracking your estimated cash inflows and outflows from investment and financing, combined with the cash generated by business operations, is the purpose of a cash flow projection.
- Investment activities might include, for example, purchasing real estate or investing in research and development outside of daily operations.
- Financing activities include cash inflows from investor funding or business loans, as well as cash outflows to repay debts or pay dividends to shareholders.
- A reliable and accurate cash flow projection is essential to managing your working capital effectively and ensuring you have all the cash you need to cover your ongoing obligations while still having enough left to invest in growth and innovation or cover emergencies.

Cash Flow	Year One	Year Two	Year Three	Year Four	Year Five
Cash Inflow					
Investments Received	$800,000	$0	$0	$0	$0
Cash from Sales	$4,723,047	$5,184,298	$5,675,431	$6,123,984	$6,593,380
Total Cash Inflow	**5,523,047**	**$5,184,298**	**$5,675,431**	**$6,123,984**	**$6,593,380**
Cash Outflow					
Preliminary Expenses	$17,500	$0	$0	$0	$0
Direct Cash Spending	$3,997,869	$4,398,782	$4,822,891	$5,191,740	$5,622,831
Cash to Payables	$548,804	$632,980	$673,086	$719,643	$741,406
Inventory Increase	$178,954	$13,231	$9,348	$7,334	$4,993
Long-Term Assets Purchased	$475,000	$0	$0	$0	$0
Total Cash Outflow	$5,218,127	$5,044,993	$5,505,325	$5,918,717	$6,369,230
Net Cash Flow	**$304,920**	**$139,305**	**$170,106**	**$205,267**	**$224,150**
Cash Balance	$304,920	$444,225	$614,331	$819,598	$1,043,748

The Balance Sheet

- **Providing a "snapshot" of your business's financial performance for a given period of time, the balance sheet contains your company's assets, liabilities, and owner's equity.**
- Assets include inventory, real estate, and capital, while liabilities represent financial obligations and include accounts payable, bank loans, and other debt.
- Owner's equity represents the amount remaining once liabilities have been paid.

Balance Sheet	Year One	Year Two	Year Three	Year Four	Year Five
Assets					
Current Assets					
Cash	$304,920	$444,225	$614,331	$819,598	$1,043,748
Inventory	$178,954	$192,185	$201,533	$208,867	$213,860
Total Current Assets:	**$483,874**	**$636,410**	**$815,864**	**$1,028,465**	**$1,257,608**
Long-Term Assets					
Long-Term Assets	$475,000	$475,000	$475,000	$475,000	$475,000
Accumulated Depreciation	$50,000	$100,000	$150,000	$200,000	$250,000
Total Long-Term Assets:	**$425,000**	**$375,000**	**$325,000**	**$275,000**	**$225,000**
Miscellaneous Assets					
Intangible Assets	$17,500	$17,500	$17,500	$17,500	$17,500
Total Misc. Assets:	**$17,500**	**$17,500**	**$17,500**	**$17,500**	**$17,500**
Total Assets:	**$926,374**	**$1,028,910**	**$1,158,364**	**$1,320,965**	**$1,500,108**
Liabilities and Capital					
Liabilities	$0	$0	$0	$0	$0
Accounts Payable	$50,321	$54,745	$59,028	$63,143	$67,202
Total Liabilities:	**$50,321**	**$54,745**	**$59,028**	**$63,143**	**$67,202**
Capital					
Paid-In Capital	$750,000	$750,000	$750,000	$750,000	$750,000

Retained Earnings	$0	$393,486	$829,320	$1,321,204	$1,865,722
Earnings	$393,486	$435,834	$491,884	$544,518	$614,169
Total Capital:	**$1,143,486**	**$1,579320**	**$2,071,204**	**$2,615,722**	**$3,229,891**
Total Liabilities and Capital:	**$1,193,807**	**$1,634,065**	**$2,130,232**	**$2,678,865**	**$3,297,093**
NET WORTH:	**$1,143,486**	**$1,579320**	**$2,071,204**	**$2,615,722**	**$3,229,891**

Activity: Projected financial statement for five years as per requirement

- From the following details prepare the financial projection for 5 years (with the template).
- Indian Oil Corporation is issuing license to operate fuel station being its agent with the following requirements (Assume you are one among the applicant):
- A land with minimum of 15 cents either owned or leased
- Construction and Installation charges would be Rs. 20 lakhs
- Assume that you are having part of the land required and remaining your are acquiring against cash.
- Loan arranged Rs. 30 lakhs with the interest of 7.4% per annum for 15 years. The EMI (Equated Monthly Installment) would be Rs. 27640
- The staff to operate 7 and 1 cashier cum manager. Each staff will be paid a salary of Rs. 9000 p.m. and cashier cum manager Rs. 15000 p.m. The salary will be revised by 5% once in two years
- The source of revenue for the fuel station is commission on Petrol and Diesel sold per liter. Rs. 3.00 commission on Petrol per liter and Rs. 2.20 commission on Diesel per liter paid by Indian Oil Corporation.
- Assume 185 liters of petrol and 220 liters of diesel are sold per day and expected to increase by 5% in each year sales.
- The average sale of oil and lubricant per month would by Rs. 120 liters that would effetely results in Rs. 15000 of profit
- There is a offer by SBI to open a ATM counter in the vicinity of the fuel station with the rent of Rs. 2000 per month.