



# Financial Performance Review for SWEng Group Three (SG3) Enterprise for the First Three Years of Trading

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## **Introduction:**

This document comprises the financial documents that indicate to the Financial Adviser our team's performance so far in this module, an analysis of our performance so far (including both from a financial perspective as well as an Interim Executive Summary from our Project Manager), information regarding our business model, pricing strategy and income sources over the financial period we are focussing upon, and a conclusion on our past and future performance as an enterprise.

Please note that more information related to our business model, income sources, product pricing, marketing plan and further expenses can be found in Appendix A.

## **Interim Executive Summary (Pending Further Research):**

### **Finance**

Overall, we have been making excellent progress whilst staying well above budget, leaving headroom for other stages of development, such as the companies' marketing campaign, which will greatly benefit the products success.

The work hours across the initial development of this project greatly varied from the predicted work structure, as it failed to take into account other priorities such as exams and coursework and assumed a uniform work distribution. On top of this, staff have worked so efficiently that tasks have been completed well within the predicted time scales, and so we have stayed well below our budget.

### **Company Structure**

To better support the staff working on this project, new roles have been introduced in our structure to alleviate pressure from the finance manager. Two of our group members have been unanimously elected during a board meeting, and they have been working with the finance manager in analysing cash flow and researching expenditure.

### **Programming**

Certain aspects of app development has been re-scheduled to prioritize the features essential to the user experience. Further development (such as the server) has been pushed back.

### **Summary**

The app has been developing nicely, with several spurts rapidly turning dreams to reality. We are all very excited to demonstrate this fantastic product soon!

## **Description of Product:**

“Hands Off!” is a new and innovative digital cookbook that aims to be user friendly. Using the app, users can be assured to find culinary diversity, catering to all kinds of specifications. Our unique design minimises screen contact when using the app, featuring a slideshow-based delivery that seeks to reduce physical interaction with the device when hands get dirty.

Most cooking apps have the common flaw in that they require constant scrolling and unlocking of the device whilst the user is cooking. This is very inconvenient if the user has dirty hands or cannot leave something unattended. “Hands Off!” Solves this issue with its’ slideshow feature where the user can tap the screen once to go to the next step and twice to go back. With this simple system, you don’t need to use your fingers, but any part of their body thereby eliminating the problem of dirty fingers on a screen.

Aimed at 18-30 year olds, the app is packed with recipes our audience would find appealing and incorporates a list of useful features. The recipes themselves provide useful information on dietary restrictions, length of time it takes to prepare and number of favourites the recipe has, giving you an idea of the popularity of the recipe. Outside of a recipe, users have access to a modifiable shopping list to keep track of recipe ingredients, as well as recipe history, favourites and a search page that allows users to search by name, keywords and dietary requirements. The app also generates suggested recipes for the user based on their history and favoured, making it easier than ever to explore new tastes and feel part of a culinary community by uploading recipes themselves for others to enjoy. With Hands Off! Our customers will never need to shell out on expensive and bulky books again!

## **Business Model of Product:**

Our product will utilise a freemium business model<sup>1</sup>, as we discussed in our initial presentation. This model, which has been made popular by products and services such as Spotify<sup>2</sup> and Tinder, as well as a cooking app called Panna<sup>3</sup>, means that the business has a free version of the product as well as a paid version, and that there are certain limitations on the free version. A successful freemium model<sup>4</sup> will have enough features on the free version to gain traction with users, but enough limitations to entice the user into purchasing our paid version of the app.

The free version of our product will have the following limitations:

- The user can only go through the steps/method of one recipe per day.
- The user can only create one recipe themselves per month.
- The user cannot download recipes.
- The user can only access certain cooking technique and recipe videos.
- Inside the recipe method, there will be an integrated (native) advert on the second slide for each recipe. There will also be a similar advert for the paid version of our app at the end of the recipe steps.
- There will be pop-up (instertitial) adverts either every 10 minutes or every time the user exits and re-enters the app.
- The user can only see the numerical ratings of a recipe (how many favoured it) and the review others found most helpful.

The paid version of our product (the way in which we will charge is covered later in the report) will have the following benefits:

- There will be no adverts.
- The user will have unlimited access to any recipe methods and creation of recipes.
- The user can download recipes and shopping lists.
- The user can upload a shopping list from the app to the website of any supermarket, for ease of shopping.
- The user can view rough pricing of ingredients within a recipe's shopping list.

Please note, however, that many of the features differentiating between free and premium will be implemented after the 18<sup>th</sup> June 2016, following discussion with the Project Manager and Software Manager.

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<sup>1</sup> Staff, "Freemium", *Investopedia*, 2018. [Online]. Available: <https://www.investopedia.com/terms/f/freemium.asp>. [Accessed: 25- May- 2018].

<sup>2</sup> "How Spotify's Business Works", *Business Insider*, 2018. [Online]. Available: <http://www.businessinsider.com/how-spotifys-business-works-2011-10?IR=T>. [Accessed: 25- May- 2018].

<sup>3</sup> Play.google.com, 2018. [Online]. Available: <https://play.google.com/store/apps/details?id=com.pannacooking.panna&hl=en>. [Accessed: 25- May- 2018].

<sup>4</sup> "Freemium Business Model | The Psychology of Freemium | Feedough", *Feedough*, 2018. [Online]. Available: <https://www.feedough.com/freemium-business-model/>. [Accessed: 25- May- 2018].

## **Product Income Sources:**

For our product we currently have two sources of income for the short-term future (however, in the constantly changing environment of the app industry we will always be open to other potential income sources), AdSense revenue and our subscription model.

### AdSense Revenue:

- Our adverts will consist of two types, native and interstitial, following consultation with the Marketing Manager and Project Manager and coming to a compromise on what would be the most beneficial for us financially and what provided minimal user dissatisfaction.
- As mentioned above, the native adverts will appear twice in every recipe method (one advert however will be for the paid version of our app), and the interstitial adverts will occur either every 10 minutes that the app has been running or every time the user exits and re-enters the app.
- The statistics for the click through rate on these adverts is shown in Appendix A.

### Subscription Service:

- Our subscription service, the paid version of our app, will charge the user a small amount annually (see below and in Appendix A for further statistics), and in exchange the user will have access to all of the aforementioned benefits as well as a monthly benefit, either in the form of vouchers and discounts or even free items, based upon the O2 rewards scheme. However, since we are intending to implement this benefit after the initial three years of trading, this feature has not been taken into account.

## **Product Pricing Strategy:**

To decide on the price of our app, research was undertaken in the form of customer surveys and online research into the typical prices for apps and companies in our industry that have similar business models.

The survey<sup>5</sup> which was undertaken around the date of 21/2/18, was used to not only decide certain app features, but as one of the final customers people were asked “How much would you expect to pay for a monthly subscription to the app described above?”, the results of which enabling us to conclude that users would prefer to pay approximately between £1.49 and £1.99 per month.

We also conducted research into how much competitors in our industry, such as BBC GoodFood<sup>6</sup> and Panna<sup>3</sup>, and our final price decision was to charge the user £1 per month, which would be £12 annually, an amount that would appeal to our demographic of users ages 18 to 30 and would also generate a large income provided a sufficient number of users began to rely on the paid version of our app for cooking.

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<sup>5</sup> S. Gilbert, "Hands Off! Cooking app survey", Smartsurvey.co.uk, 2018. [Online]. Available: <http://www.smartsurvey.co.uk/s/CP2SH/>. [Accessed: 25- May- 2018].

<sup>6</sup> See Appendix A

## **Product Marketing Plan Summary:**

Covered in more detail in Appendix A, our marketing plan will be our main foreseen expense over the coming 3 years, as it will be the way in which our product will have a greater reach, and will consist of the following:

- Attending fresher's fairs at universities, where we can talk to students (typically the lower age range of our demographic) and show them our product while explaining the features and benefits of both free and premium versions.
- Flyers (covered in more detail in Appendix A).
- Advertising on both search engines (such as Google) and social media platforms (such as facebook)-however the costs of implementing such advertising is not crystal clear.
- We also have the aim, after the initial three years, to work with brands such as cooking sauces (eg: Nando's or Encoda), once we have gained a sufficient user base and cultivated a reputation for the quality and success of our product. However, since this is outside the financial period we will be focussing on in this report, such costs have been disregarded for the time being (though they are mentioned in Appendix A).

## **Future Product Expenses:**

While the expenses are covered in more detail in Appendix A, we foresee the following expenses in the near future:

- Purchase of a domain name.
- Cost of marketing (as mentioned above).
- Either rental or purchase of a server (though as mentioned in Appendix A, this investment will most likely be made after the selected financial period has ended).
- Higher quality video and photography equipment (however we intend to use the equipment utilised in the development phase for video making in the first three years at least, meaning that such a cost will be currently ignored).

[illegible]



**Please note the following statements related to the above cash flow:**

- Please note that the actual hours used in the first financial report were erroneous in dispersion. This has since been corrected in reports two and three, as shown by the above actual hours in this report.
- The dividing line between the actual and forecast values in the cash flow (as indicated by the vertical bold blue line in the cash flow) indicates that the actual values are from 08/01/18 to 29/04/18, and that the forecast values are from 30/04/18 until the end of the development cycle for our product.
- The section between the vertical bold green line and the vertical bold blue line in the above cash flow indicates the period of time that is the focus of this financial report.
- The forecast wages paid in week 17 are the actual accrued wages in week 16, since this cash flow is meant to utilise our forecast accurately to predict our closing balance at the end of the development cycle.
- The loan is approved in week 8, one week later than envisaged, and loan interest has been adjusted accordingly.
- The dates agreed for the handover and acceptance of code, as shown in the contracts (see appendix D), are different to the dates predicted, and the cash flow has been subsequently modified.

## **Profit and Loss Statements for Product's Development Phase and First Two Years of Trading:**

Notes		Forecast	Development	Launch Yr 2	Growth Yr 3
		Yr 1-24 Weeks	Yr 1-24 Weeks	52 Weeks	52 Weeks
		£	£	£	£
	<b>Income:</b>				
1.	Advertising Income			850	850
2.	App Subscription Income			360,000	360,000
3.	Contract Income	128	1,000	-	-
	<b>Total Income:</b>	128	1,000	360,850	360,850
	<b>Direct Development Costs:</b>				
4.	Wages:				
	Project Management	3,943	2,225		
	Quality Assurance and Documents Management	2,169	2,003		
	Software Management	4,503	3,191		
	Design Management	1,869	1,347		
	Finance Management	4,400	2,919		
	Multimedia& Content Management	2,556	1,531		
	GUI Management	2,272	2,159		
	Marketing Management	2,338	2,031		
	<b>Total Wages:</b>	24,050	17,406	21,750	22,294
	<b>Other Development Costs:</b>				
5.	Contract Costs	128	1,000	-	-
	Advertising and Marketing Costs	-	-	58,026	58,026
	<b>Total Direct Development Costs:</b>	24,178	18,406	58,026	58,026

Notes		Forecast	Development	Launch Yr 2	Growth Yr 3
		Yr 1-24 Weeks	Yr 1-24 Weeks	52 Weeks	52 Weeks
		£	£	£	£
	<b>Indirect Development Costs:</b>				
	Overheads:				
6.	Rent	15,185	15,185	33,723	34,566
6.	Utilities	1,200	1,200	2,665	2,732
6.	IT infrastructure	2,400	2,400	5,330	5,463
	<b>Total Overheads:</b>				
7.		18,785	18,785	41,718	42,761
8.	Interest	2,215	2,025	8,430	8,430
	<b>Total Expenditure:</b>				
		45,178	39,216	129,924	131,511
	<b>Income less Expenditure:</b>				
9.	<b>Net Profit or Loss:</b>	<b>-45,050</b>	<b>-38,216</b>	<b>230,926</b>	<b>229,339</b>

## **Notes:**

### 1. Advertising Income:

- This has been calculated as:  $5,000 \times 17p = £850$
- This is based on a separate research document included.
- A cautious view has been taken and no increase in Year 3 has been included.

### 2. Subscription Income:

- This has been calculated as:  $£12$  per subscriber for a volume of  $30,000 = £360,000$
- This is based on a separate research document included.
- A cautious view has been taken and no increase in Year 3 has been included.

### 3. Contract Income:

- This income was planned and finally negotiated and achieved during the Forecast and Development Periods.

### 4. Wages:

- These are less than forecast owing to less hours being worked than was originally envisaged in the Work Breakdown Schedule.
- Wages from 7/5/2018 to 18 /5/18 have yet to be paid and are included in Creditors and Accruals.
- Wages for years 2 and 3 are calculated as follows:

Year 2:

3 staff performing overlapping roles, using top end £29k salary estimates from Target Recruitment[53], for 3 months/13 weeks=  $3 \times 29k \times 3 \text{ months} = £21,750$

(Target[53] = 26-29K, Telegraph[52] = 27K, Reed [54]= 39K

Year 3:

$£21,750 \times \text{CPI } 2.5\%[55] = £22,294$

(CPI: Consumer Price Index Rationale: Per Office of National Statistics:

- to March 2018 = 2.3%

-to February 2018 = 2.5%

-Annual Average Rate March 2017 to March 2018 = 3.2%

-Therefore, median 2.5 % rate used for inflationary price increases throughout).

#### 5. Contract Costs:

-These were planned and finally negotiated and achieved during the Forecast and Development Periods.

#### 6. Overheads:

-These were prescribed as Rent, Utilities , and IT and Forecast and Development costs are therefore the same.

- Overheads that are unpaid by 7 May 2018 have been included in Creditors and Accruals.

Overheads for Years 2 and3 are calculated as follows:

	Forecast £	Development £	YR 2 £	YR 3 £
			CPI 2.5% (see note 4 above)	CPI 2.5% (see note 4 above)
	24 weeks	52 weeks		
Rent	15,185	32,900	33,723	34,566
Utilities	1,200	2,600	2,665	2,732
IT	2,400	5,200	5,330	5,463
Total	18,785	18,785	41,718	42,761

#### 7. Overhead Recovery Rates:

-Using Overheads before interest from above and direct labour hours below:

Development £	YR 2 £	YR 3 £
52 weeks	CPI 2.5%	CPI 2.5%

Overheads	18,785	41,718	42,761
Total Direct Labour Hours	1,392.5	1,365	1,365
Overheads divided by Hours	£13.49	£30.56	£31.33

( Year2 and 3 Direct Labour Hours calculated as follows:

3 staff, 35 hour weeks, for 13 weeks = 1,365. same for both years.)

#### 8. Interest:

-No new loans are envisaged for years 2 and 3, provided App subscription levels of 30,000 subscribers can be achieved.

- If this is not achieved, then further loan financing will be required.

-Further loan financing may or may not be available on the same terms provided for the Forecast and Development phases.

	Forecast £	Development £	YR 2 £	YR 3 £
	24 weeks	52 weeks	CPI 2.5%	CPI 2.5%
Interest	2,215	2,025	8,430	8,430
	16.86% APR Compound Interest	16.86% APR Compound Interest BUT beginning 1 week later than originally forecast(therefore lower number).	Taken as 16.86% APR BUT as terms may not be the same, then simple interest used.	Taken as 16.86% APR BUT as terms may not be the same, then simple interest used.

- In addition, financing may be needed from alternative sources.

These are available as follows:

- Small Business Administration (SBA-USA) states rates as maximum 9%. [56]

- Santander provides rates between 4.8% and 24.9%. [57]

-A comparison site provides rates as low as 3%. [58]

#### 9. Return on Capital Employed:

-This has only been calculated where gains are envisaged in years 2 and 3 ( the development period makes a loss).

-Such gains are only feasible if App subscription levels can be attained (30,000).

-It is envisaged that profits will be retained in the business and not immediately used to repay the £50k Loan Capital.

ROCE (NONE IN DEVELOPMENT PERIOD BECAUSE NO GAIN)

2019	230,926	divided by	50,000	is 4.62
2020	229,339	divided by	50,000	is 4.59

## **Balance Sheets for Product's Development Phase and First Two Years of Trading:**

Notes		Forecast	Development	Launch Yr 2	Growth Yr 3
		Yr 1-24Wks 18/6/2018	Yr 1-24Wks 18/6/2018	52 Weeks 18/6/2019	52 Weeks 18/6/2020
	<b>Current Assets:</b>		£	£	£
1.	Cash	4,950	22,253	242,710	474,049
	<b>Current Liabilities:</b>				
2.	Creditors and Accruals	-	10,469	-	-
	<b>Current Assets less Current Liabilities - Net Assets:</b>	<b>4,950</b>	<b>11,784</b>	<b>242,710</b>	<b>474,049</b>
	<b>Capital and Reserves:</b>				
	Loan Capital	50,000	50,000	50,000	50,000
	Retained Profits or Losses:				
	Yr 1 Net Loss	-45,050	-38,216	-38,216	-38,216
	Yr 2 Net Profit			230,926	230,926
	Yr 3 Net Profit				229,339
	Total Reserves:	-45,050	-38,216	192,710	422,049
	<b>Total Capital and Reserves:</b>	<b>4,950</b>	<b>11,784</b>	<b>242,710</b>	<b>472,049</b>



## **Notes:**

### **1. Cash:**

- The Forecast cash balance is that submitted in the original Financial Plan cash flow.
- The Development Year cash balance is that as at 7 May 2018, as submitted in the cash flow for this Financial Performance Review. This balance will be needed to cover:
- Creditors and Accruals needing to be settled by 18 June 2018.(These may turn out to be larger than expected as product development is still continuing and this could increase direct labour hours costs).
- Some of the £58,026 Advertising Costs to begin the second and third Launch and Growth years.

## **Notes(ctd):**

### **1. Cash(ctd):**

- Cash flows for years 2 and 3 can be summarised as follows:

	£	£
Brought forward from Development Phase and from Year 2:	11,784	242,710
Income	360,850	360,850
less costs	129,924	
less costs		131,511
Cash left	<b>242,710</b>	<b>472,049</b>

## **2.Creditors and Accruals:**

-Creditors and Accruals only apply to the Development Period and cover from 7 May 2018 to 18 June 2018 (ie: remaining costs yet to be paid).

-The relevant £10,469 includes the following:

<b>Creditors and Accruals:</b>	<b>£</b>
Project Management	722
Quality Assurance and Documents Management	556
Software Management	341
Design Management	300
Finance Management	547
Multimedia and Content Management	490
GUI Development / Management	90
Marketing Management	597
Rent	3,796
Utilities	700
IT Infrastructure	1,400
Interest	930
<b>Total Creditors and Accruals:</b>	<b>£10,469</b>

## **Other Financial Information:**

### **Net Present Value:**

	Year 1	Year 2	Year 3
Net Cash Flow (Cash Balance from Balance Sheet, £)	11,784	10,729	8,118
Formula	$\frac{11,884}{(1 + r)}$	$\frac{10,729}{(1 + r)^2}$	$\frac{8,118}{(1 + r)^3}$
Libor Rate (23 May overnight rate)	0.47371		
Present Value (£)	7996.145782...	4940.093677	2536.372031...
Net Present Value (£)	15472.61149... = £15,472.61 (rounded to 2 dp)		

Therefore, the projected earnings of our product exceed the anticipated cost.

## **Conclusion:**

1. A provisional 3 year maximum window has been examined, as all initial assumptions may need to change after that time span. (The app market is volatile and much depends on uptake traction and gaining market share). If anticipated subscription volumes are not finally achieved, additional loan financing may be required to cover costs.
2. Using full absorption costing for sales pricing is not feasible in view of what the app market will bear (low price 17p per app advertising income is offset by more easily attainable and valuable £12 per subscriber per annum app income).
3. Full absorption costing and costs recovery are achieved in Year 2 provided:
  - the volume of app subscribers can be obtained. (Volumes have been kept the same for year 2 and year 3 to ensure a conservative approach is maintained).
  - the volume of app uptake can be obtained. (Volumes have been kept the same for year 2 and year 3 to ensure a conservative approach is maintained).
  - the advertising costs known so far prove to be accurate and are not understated.