Financial Planning

Reproduction of your venture, using financial data

FINANCIAL PLANNING

Function of Financial Planning:

- Determination of the future need for capital and finance of the venture / project

Goals:

- Ensure that the venture will be able to pay at any time
- Ensure that the company can get financed adequately
- Ensure that the company reaches its goals, and has the funds to do so

- Cash Flow Planning
- Capital planning
- Controlling

1. Determine capital needed (especially necessary assets)
2. Working capital

Uncertainty in the field of start-ups:

- Working capital cannot be calculated by using averages
- Greatly dependent on actual configuration of the organisation and the venture

Financial Planning – Essential Steps

Initial necessary funding

- What do you need to achieve your first sales?

Revenue-based financial requirements

- What cost are generated by revenues?

Ongoing fixed cost

- Which costs are generated even with no revenues?

- Investment planning
- Staff Planning

- Revenue Planning
- Expense Planning

- Cash Flow Planning

Three building Blocks

Cash Flow Planning

Profit and Loss-Statement

Balance Sheet

Three building Blocks

Cash Flow Planning

Profit and Loss-Statement

Balance Sheet

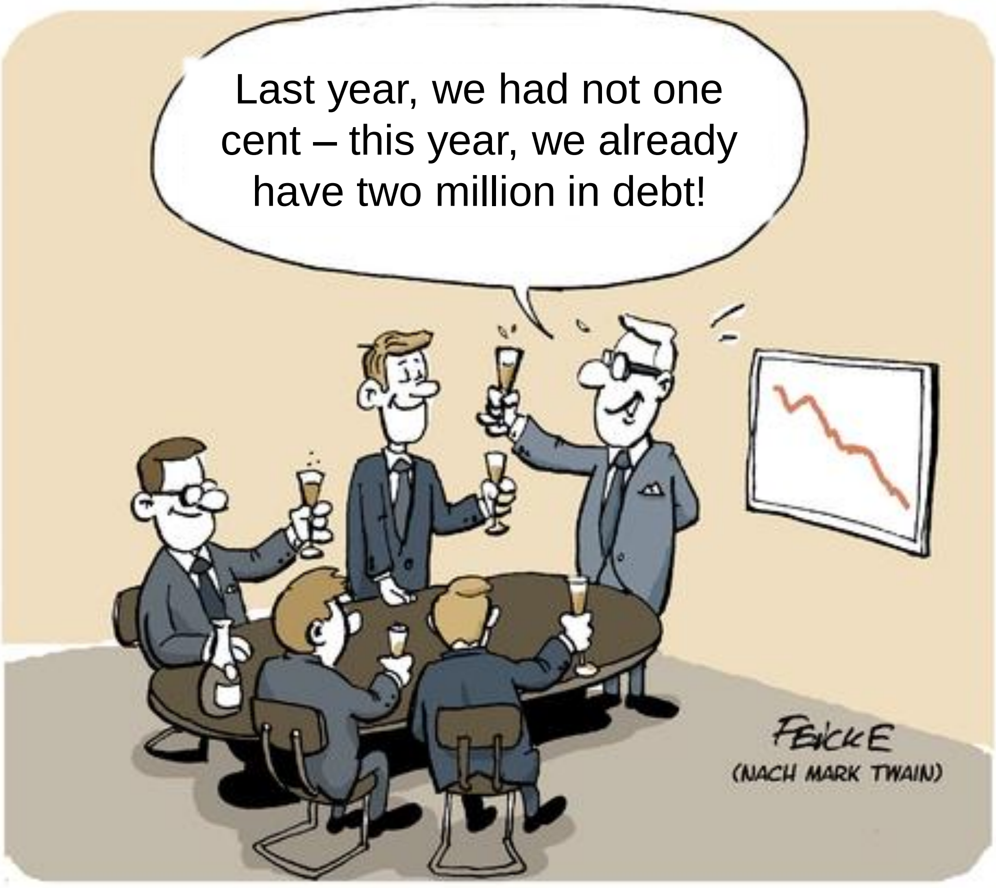
Cash Flow: Cash in and Cash out over a Period of Time

Cash Flow Planning

- **Cash Flow from Operations**
  - Revenues
  - Staff
  - Cost of Goods Sold
- **Investment Cash Flow**
  - Investment in Machinery
  - Real Estate
- **Financial Cash Flow**
  - Borrow or repay loans
  - Capital Increase
  - Payment of Dividends

Cash Flow During Company Growth

- Raising Revenues ⟶ Negative Cash Flow from Operations!
    - Inventory must not only be restocked, but must increase
    - Payment Periods – Cash from revenues may come later
    - But: Inventory must be restocked now!
- Growth phase: Cash Flow mostly from financial cash flow
- Maturity phase: Cash Flows mostly from operations



Three building Blocks

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Cash Flow Planning

Profit and Loss-Statement

Balance Sheet

P&L: Results of a Period – Profit or Loss

Profit & Loss-Statement

Income			./. Cost		
Revenues	Change of Inventory	Work-in-progress	Cost of Goods Sold – Materials & Services	Staff cost	Other cost

Three building Blocks

Cash Flow Planning

Profit and Loss-Statement

Balance Sheet

Balance Sheet:
Assets and Source of Capital at a certain date

Balance Sheet

- **Assets**
  - **Long-term Assets**
    - Machinery, Intellectual Property, Shares in other companies
  - **Current Assets**
    - Accounts receivable
    - Cash, Bank Accounts
    - Inventory, unfinished products
- **Liabilities & Equity**
  - **Liabilities**
    - Bank loans, accounts payable
  - **Equity**
    - Invested Capital
    - Retained Earnings

Goals of Financial Planning

<u>The goal of your financial planning is to answer the following questions</u>:

- How much is necessary to implement your planned operational processes?
- At what point in time do you need which amount of money, and where may it come from?
- What impact does that have on the development of your company?
- What (financial) results can you expect for your company?

...and remember:

"Didn't I just give you money for a start-up *last* week?"

Bancruptcy & Insolvency: If you cannot pay your bills, you are bancrupt !

Revenue Planning

- What are your products & services – how do you create revenues?
- Differentiate between order, delivery of goods, and payment
- Terms of payment, down payments, cost of goods sold

Projected Sales:	2021	2022	2023	2024
Product 1	0	0	0	0
Product 2	0	0	0	0
Service 3	0	0	0	0
Σ	0	0	0	0
Share of Cost of Goods sold product 1	60%			
Share of Cost of Goods sold product 2	40%			
Terms of Payment:				
Down Payment - at order:	At order:	After Delivery:		
	25%	75%		
Due date for payment:	60 Days			

	Jan 21	Feb 21
Total revenue:	**- €**	**- €**
Total Orders:	**- €**	**- €**
Product 1	- €	- €
Product 2	- €	- €
Service 3		
Maintence contracts	- €	- €
Total Deliverys:	**- €**	**- €**
Product 1	- €	- €
Product 2	- €	- €
Service 3		
Maintence contracts	- €	- €
Down Payment on order:	**- €**	**- €**
Product 1	- €	- €
Product 2	- €	- €
Maintence contracts	- €	- €
Payment at Delivery:	**- €**	**- €**
Product 1	- €	- €
Product 2	- €	- €
Service 3	- €	- €
Maintence contracts	- €	- €

Profit- & Loss Statement

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- Excise Duty: Sales Tax
- Stock-in-Trade: Inventories, that are sold right away

Statement of Profit and Loss for the year ended March 31,2014

₹ million

Particulars	Note No.	Year ended March 31, 2014	Year ended March 31, 2013
REVENUE			
Sale of products		38,041.27	32,949.37
Less: Excise duty		4,005.15	3,512.45
Net sale of products		34,036.12	29,436.92
Sale of services		309.32	137.02
Other operating revenue		21.15	15.21
Net revenue from operations	17	34,366.59	29,589.15
Other income	18	455.14	465.51
Total Revenue		**34,821.73**	**30,054.66**
EXPENSES			
Cost of materials consumed	19	21,011.95	17,603.12
Purchases of stock-in-trade	20	2,113.69	2,632.54
Changes in inventories of finished goods, work-in-process and stock-in-trade	20	(292.10)	(320.89)
Employee benefits expense	21	1,583.16	1,262.30
Finance costs	22	7.18	2.69
Depreciation and amortisation expense [includes impairment loss of ₹Nil (PY ₹75.52 million)]	23	645.71	660.92
Other expenses	24	4,346.60	3,904.24
Total Expenses		**29,416.19**	**25,744.92**
Profit before exceptional items and tax		**5,405.54**	**4,309.74**
Less: Exceptional items (net)	33	38.84	91.57
Profit before tax		**5,366.70**	**4,218.17**
Less: Tax expense			
Current tax		1,580.00	1,377.97
Deferred tax (credit) / expense		106.23	(24.51)
Earlier year's (excess) / short provision		6.11	(2.34)
Profit for the year		**3,674.36**	**2,867.05**

Cash Flow Planning

Cash Flow	Jan 21	Feb 21
Bank Balance - Start of Month	- €	- €
Cash Inflow	- €	- €
Cash Outflow	- €	- €
Bank Balance - End of Month	**- €**	**- €**
Checking Account		
liquid funds ("cash")	**- €**	**- €**
Incoming Payment	**- €**	**- €**
Incoming Payment Sales of Goods	- €	- €
Incoming Payments Sales of Services	- €	- €
Incoming Payments - other income	- €	- €
Raising of Credit	- €	- €
Raising of Equity	- €	- €

Cash Flow	Jan 21	Feb 21
Inventory Expenses	- €	- €
Staff Expenses	- €	- €
Sales Commission	- €	- €
Rent & Lease expense	- €	- €
Insurance expenses	- €	- €
Communication Expenses	- €	- €
Travel Expenses	- €	- €
Advertisement Cost	- €	- €
Expenses for office material	- €	- €
Expenses for Consulting (legal/tax/business)	- €	- €
Accounting Expenses	- €	- €
Interest & financial fees	- €	- €
Other Expenses	- €	- €
	- €	- €
Repayment of loans		
Cash dividend	- €	- €

Make or buy?

- In many situations, you can choose to create something inside the company („make“), or to source it from outside („buy“)
- Make it yourself: Typically, created by your staff, using your machinery
  - -> high fixed cost – staff expenses, machine appriciation, interest for tied-up capital
  - -> high reliability, in terms of quality and availability
  - -> if produced effectively: more cost-efficient
- Buy from supplier/partner: no upfront investment needed, more flexibility
  - -> less need for capital, but higher cost per piece (esp. in large quantities)

Start with buy, if not strategically relevant
Change to make later, if financially attractive

Typical errors

- Revenue drivers not recognized
  - Who buys, how often, how much
  - 99% of all entrepreneurs are too optimistic

Where are the starting points to increase sales?

- No comparative figures
  - (Planned) Key figures differ greatly from the rival/industry

If you can do better than the competition, you have to justify that!

Source: Zacharakis (2004)

Typical errors (II)

- Time to first sales underestimated
  - Immediate start of sales unrealistic
  - Cost run up before first sales are generated
  - Years may pass before full occupancy is reached

Calculate a ramp-up time without sales!

- Underestimated costs
  - Revenue growth and cost growth don't match up
  - Millions of revenue per employee unrealistic
  - Infrastructure demand and marketing costs (customer generation and – support) is underestimated

Also look at (supposed) fixed costs – more revenue means more space needed, employees, ...!

Source: Zacharakis (2004)

Typical errors (III)

- Top-down vs. bottom-up forecasts
  - Sales are defined as market share
  - Even 2% market share is very difficult to achieve

Market share is a result of achievable sales, not the other way around!

- Underestimated Time requirement for financing
  - Searching for investors takes time (looong time…)
  - 6 months is not a long time!
  - And negotiations can also drag of…

Allocate enough time!

Source: Zacharakis (2004)

Venture Financing

Where does the money come from?

Financing phases

Financing phase	Early Stage		Expansion Stage	Later Stage	
	Seed	Startup	Expansion	Bridge	MBO/MBI
Corporate Phase	• Product concept • Market analysis • Basic development	• Setting up • Development to product maturity • Marketing concept	• Product Launch • Growth financing	• Preparing an IPO or sale to industrial investor	• Acquisition by existing (MBO) or external (MBI) management
Profit-/Loss and Risk Expectation of the Startup / Company					
Typical sources of funding	Own funds Public. Funding		Venture Capital	Debt	Stock exchange
Typical management problems	• Assessment of product idea and market • Professionalism	• Investor distrust • Search for key personnel and staff	• Debt financing • Building market position and image	• Stronger competition • Organisational problems	• Management's financial strength • Dynamics of the management team

Selection of capital sources – Founder‘s View

Financial criteria

- Volume of financing needed
- Appropriation
- Temporal availability
- Risk-taking
- Cost of raising capital

Business criteria

- Start-up support
- Leadership support
- Additional benefit from administrative and marketing assistance

Other criteria

- Degree of independence of the company

Selection of capital sources – Investor‘s view

Financial criteria

- Return and risk (believed to be very high)
- Liquidity
- Portfolio optimization (diversification)

Risk-related criteria

- Easyness of assessment
- Minimizing agency experience: rights of intervention and monitoring

Business criteria

- Exit variants

Sources of funding- Equity

- 4F – Founder, Family, Friends, and other „Fools“
- Employees
- Business Angels
- Institutional investors
- Incubators
- Accelerators
- Media for Equity
- Crowdfunding/ Crowdinvesting
- Public funding

Equity from the founder

- Main source of capital
- Signal of seriousness
- Simple, formless process
- As a rule, a prerequisite for grants, other investors and debt capital
- Can also be brought as material (including rights and patents!), or working for free
- (Future) Employees as co-founders

Equity from family and friends

- "Easy" access
- Basic confidence exists already
- But: Personal relationships can be influenced by the failure of the enterprise!

- Risk clarification – a total loss is possible!
- Shareholder contract
- The investor needs to understand the business
- What happens when the personal relationship ends?

Sources of funding- dept capital

- Family and friends
- Banks
- Business partners
    - Suppliers
    - Customers
    - Strategic partners
- Institutional investors
- Public funding

Banks and credit institutions

- Classic debt financing through loans and mortgages
- Quick fundraising
- Comparatively low costs
- Low foreign influence
- Collateral needed
- No support services
- Innovative start-up projects generally do not receive credit because of high risk

Capital cost of debt

- Cash reflow on credit: Interest + repayment
    - Interest: Price of borrowed capital
    - Repayment: Repayment of borrowed capital

- Rate loan: Constant repayment, but decreasing interest payments-> Payment amount decreases over time
- Annuity loan: Constant payment amount because repayment amount increases with decreasing interest burden

Bootstrapping

Bootstrapping: The process of growing a business with very limited resources, and no external input
-> Cash flows are generated through your business model, not from external investors

Savings of Founders + **3 F – Family, Friends, Fools**

Benefits	Disadvantages
• Independence, since no „external" investors are involved • No distraction by investor needs of repayment (= selling the company) • Immediate start of operations possible	• High physical and psychological strain on founders • Restricting entrepreneurial activity due to low financial resources • Positive cash flow must be achieved in a timely manner

Financing approaches

Basic model	Form of financing	Funding instruments
• No-budget model: No funding round	• Self-financing • "Self feeding business"	• "Sweat Equity" • (Paid) Research/development projects • Services • Down payments
• Low budget model: One funding round	• Self-financing and debt financing • Bootstrap Financing • Traditional start-up financing	• Founder's capital • F + F Capital • Bank loans • Supplier loans • Leasing
• Big budget model: Several rounds of financing	• Self-financing and debt financing • Equity Investors • Life-Cycle financing	• Seed Capital • Business Angels • (Corporate) Venture Capital, Private Equity • Initial Public Offering (IPO) + Financial instruments of bootstrapping

Nathusius, 2002

Development approaches

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Development approach	Founding financing model	Frequency of occurrence
Case type 1: "Start small, stay small"	No – Low Budget	85-90%
Case type 2: "Start small, but grow"	No – Low Budget	8-12%
Case type 3: "Start big and grow"	Big Budget	1-2%

Nathusius, 2002

Sample companies

Founding financing model	Sample companies		
Bootstrap Finance	Dell Eds Fielmann Grundig	HP ThyssenKrupp SAP Stinnes	United Internet Virgin Vobis Würth
Big Money Model	Amazon Apple Cisco Compaq	DEC Intel Lycos Mobilcom	Quiagen Ricardo.com.au Uunet Yahoo

Even without large seed capital, great success is possible!

Nathusius, 2002