

The Financial Plan

Topics covered:-

- ✓ 1. Operating and capital budgets
2. forecasting sales
3. pro forma income statements
- ✓ 4. pro forma cash flow statement
- ✓ 5. pro forma balance sheet
- ✓ 6. break-even analysis
7. pro forma sources and applications of funds statement
8. software packages.

The Financial Plan

- ☐ It provides the entrepreneur with a complete picture of:
 - ☐ The amount funds and when they are coming into the organization.
 - ☐ Where funds are going and how much cash is available.
 - ☐ The projected financial position of the firm.
- ☐ The plan explains how the entrepreneur intends to meet financial obligations and maintain the venture's liquidity.

Operating and Capital Budgets

- These are developed before developing the pro forma income statement.
- Sales budget – An estimate of the expected volume of sales by month.
- Cost of sales can be determined from the sale forecasts.
- In manufacturing ventures, costs of internal production and subcontracting are compared.
- Includes estimated ending inventory required as a buffer.

	Jan.	Feb.	Mar.
Projected sales (units)	5,000	8,000	12,000
Desired ending inventory	100	200	300
Available for sale	5,100	8,200	12,300
Less: beginning inventory	0	100	200
Total production required	5,100	8,100	12,100

Figure 1-A Sample Manufacturing

Operating costs:

- Includes fixed expenses incurred regardless of sales volume.
- Variable expenses must be linked to strategy in the business plan.

Capital budgets:- provide a basis for evaluating expenditures that will impact the business for more than one year.

Expense	January	February	March
Salaries	\$23.2	\$23.2	\$26.2
Rent	2	2	2
Utilities	0.9	0.9	0.9
Advertising	13.5	13.5	17
Selling expenses	1	1	1
Insurance	2	2	2
Payroll taxes	2.1	2.1	2.5
Depreciation	1.2	1.2	1.2
Office expenses	<u>1.5</u>	<u>1.5</u>	<u>1.5</u>
Total expenses	\$47.4	\$47.4	\$53.9

Figure 2 - A Sample Operating

Pro Forma Income Statements

- Pro forma income - Projected net profit calculated from projected revenue minus projected costs and expenses.
 - Sales by month is calculated first.
 - Basis of the figures - Marketing research, industry sales, trial experience, forecasting, and financial data on similar start-ups.
 - Projections of all operating expenses for each of the months during the first year should be made.
- Increasing selling expenses as sales increase should be taken into account.
- Changes in expenses during the first year can necessitate month-by-month illustration.
 - Increase in individual expenses need to be reflected in the first year's pro forma income statement.
 - Projections should be made for years 2 and 3 as well; consider expenses that are likely to remain stable over time.

Pro Forma Cash Flow

Projected cash available calculated from projected cash accumulations minus projected cash disbursements.

It is not the same as profit.

Sales may not be regarded as cash.

Use of profit as a measure of success may be deceiving if there is significant negative cash flow.

Cash flow can be projected using the indirect or direct method.

Break-Even Analysis

Breakeven - Volume of sales where the venture neither makes a profit nor incurs a loss.

☐ The break-even formula:

$$B/E(Q) = \frac{\text{TFC}}{SP-VC/\text{unit (marginal contribution)}}$$

☐ Major weakness in calculating the breakeven lies in determining if a cost is a fixed or variable.

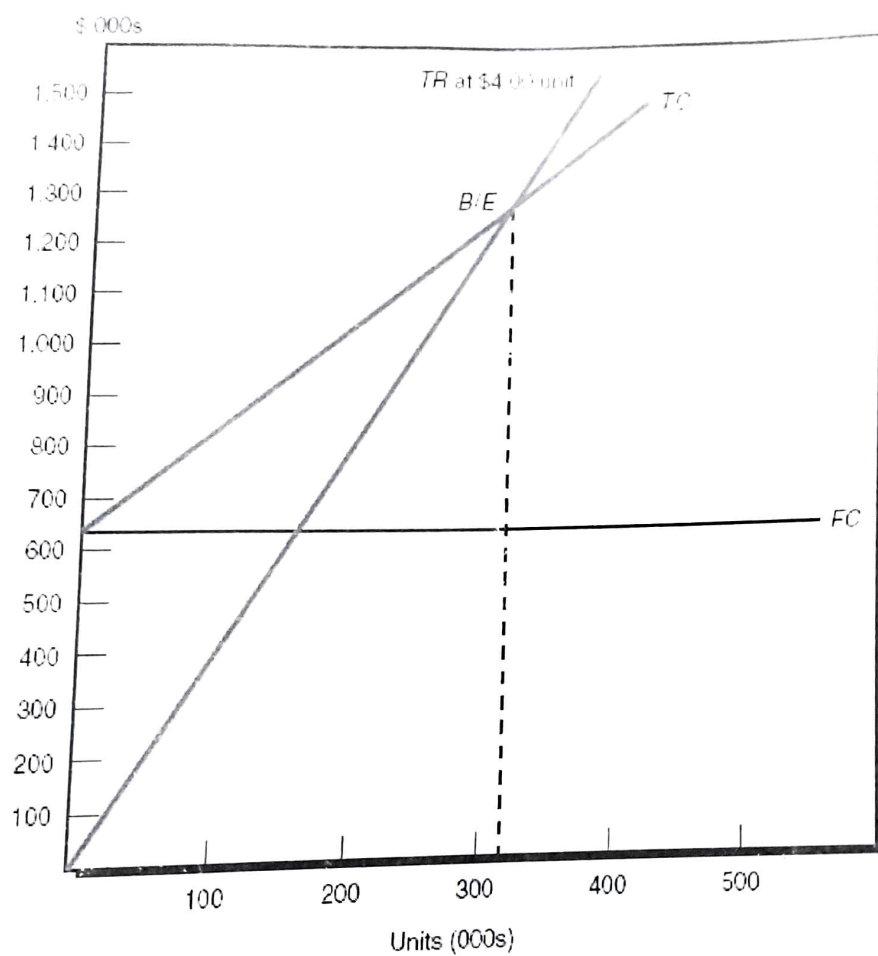


Figure 3 Break even analysis

Pro Forma Sources and Applications of Funds

- ☐ Sources:
- ☐ Operations.
- ☐ New investments.
- ☐ Long-term borrowing.
- ☐ Sale of assets.
- ☐ Uses/ Applications:
- ☐ Increase assets.
- ☐ Retire long-term liabilities.
- ☐ Reduce owner or stockholders' equity.
- ☐ Pay dividends.

Software Packages

- ☐ A spreadsheet program (Microsoft Excel) is most suitable for completing pro forma statements.
- ☐ Helps present different scenarios and assess their impact on the pro forma statements.
- ☐ A simple and easy to use software is useful in the start-up stage.
- ☐ Software packages vary in price and complexity.