The Financial Plan

Chapter 8

Chapter 8

"The highest use of capital is not to make money, but to make money to do more for the betterment of life."

— *Henry Ford*
Manufacturing Entrepreneur and Philanthropist

Overview: The financial plan is the last section to be completed, as it reflects the decisions made in the other parts of your business plan. For example, if you project selling a certain volume of products or services at designated prices, these numbers are indicated in your sales forecast. Equally, the type and frequency of advertising you have chosen as well as the number of staff you will need to support these efforts bear costs evidenced in your marketing plan. Each planning decision is associated with numbers that when aggregated form the basis of your financial documents.

> **Treatment of Accounting and Finance**
>
> Because there are volumes of accounting and finance books available, technical information on preparing financial statements and budgets is treated in this manual (in relative terms) superficially. This does not diminish the importance of having an excellent accounting system in place and qualified accounting professionals on staff.

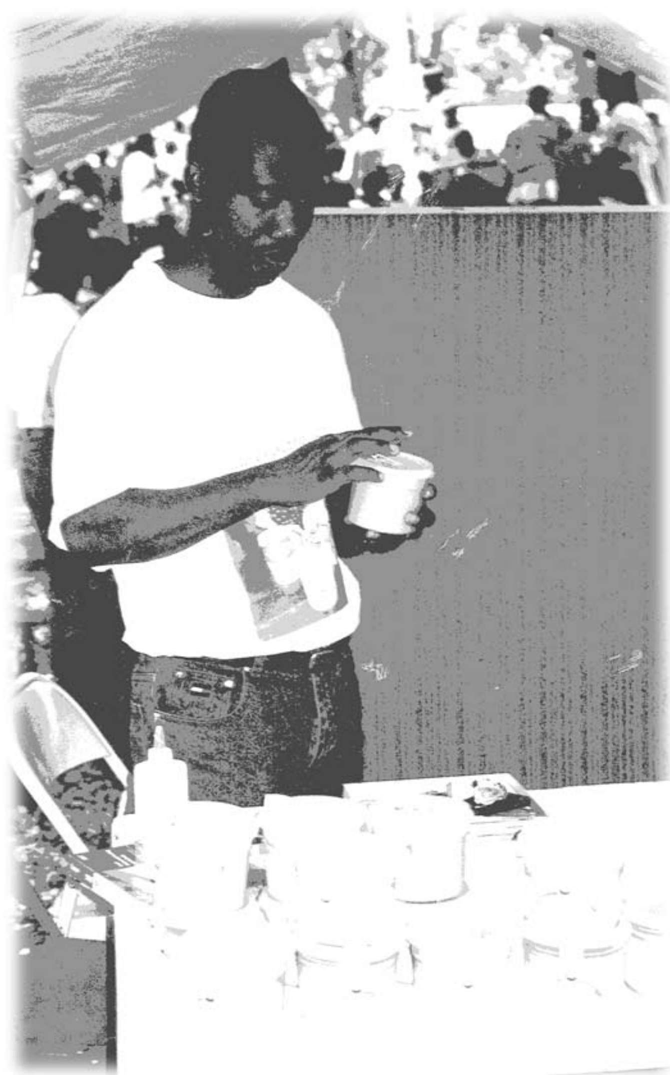
This chapter examines useful financial **targets** for social enterprise business planning as well as four critical financial tools: the **balance sheet**, **profit and loss statement**, **cash flow statement**, and **budgets** and methods to **quantify social costs** in accounting. Also discussed are how social enterprise **cost structures** and **resource acquisition** differ from those in private businesses and why.

Financial Planning Objectives

As with the other operational components of the business plan, the objectives of the financial plan must feed into the overriding objectives of the social enterprise (chapter 2). In fact, there should be some overlap between the larger financially oriented objectives, such as cost recovery or net profit/loss, and the objectives set out in your financial plan (exhibit 8A). Other objectives stated in the financial plan support attaining these larger objectives by giving enterprise management and PO business advisors valuable information toward this end. For example, TARTINA uses several ratios that determine profitability, efficiency, and liquidity to benchmark progress toward achievement of its sustainability objectives.

Selecting Financial Objectives

- ▲ Financial objectives of the social enterprise must be separate from those of the parent organization and the implementing partner (chapter 2).
- ▲ When setting objectives, wear the hat of every important stakeholder and ask the question, "What are the financial objectives for this social enterprise from my perspective?"
- ▲ Use exhibit 8A as a guide from which to select your financial planning objectives. This is not a complete list of possible objectives, so additions that suit your particular social enterprise are fine.
- ▲ Select financial objectives appropriate for your enterprise. No absolute number is specified; you will need to set a sufficient number to track financial information pertinent to your social enterprise. TARTINA uses all the objectives in exhibit 8A. Remember that you will have to follow and evaluate any objective you choose, a task that takes time and human capacity. The following exercise will help you determine if you are being unrealistic in your selections.



A sales agent sets up TARTINA display of Mamba products.

Exhibit 8A: Financial Planning Objectives for Social Enterprises

Type of Objective	What It Measures	How to Calculate	Primary Users	Reporting Period	Information Source
Cost Recovery	Ability of enterprise to cover its costs through generated revenue	% = ***Gross income*** minus expenses	Public donors Investors PO Business Advisor Enterprise Manager	Quarterly Annually	Profit/loss statement
Cost Efficiency	Ability of enterprise to render services at a decreasing cost over time	$ = Expenses divided by # of clients	Public donors Investors PO Business Advisor Enterprise Manager	Quarterly Annually	Profit/loss statement
Operating self-sufficiency[1]	Ability of enterprise to cover its costs through generated revenue (with or without) using borrowed funds	$ = Income divided by operating costs + financial costs of loans + reserves/or loss provisions	Public donors Investors PO Business Advisor Enterprise Manager	Quarterly Annually	Profit/loss statement
Average Client Revenue	Ability of enterprise to generate increasing revenues per client over time	$ = Gross income divided by # of clients	Public donors Investors PO Business Advisor Enterprise Manager	Quarterly Annually	Profit/loss statement
Net Profit/Loss	Enterprise's progress toward financial viability	$ = Enterprise gross income minus expenses	Shareholders Public donors Investors PO Business Advisor Enterprise Manager Entrepreneurs	Quarterly Annually	Profit/loss statement
Gross Profit Margin	Ability of enterprise's product or service revenues to contribute to covering fixed costs	% = (Sales minus cost of goods sold) divided by sales	Enterprise Manager	Quarterly Annually	Profit/loss statement
Budget Expenditure Pattern	Enterprise's implementation of activities as planned	% = Actual expenses divided by planned budgeted expenses	Public donors PO Business Advisor Enterprise Manager	Quarterly Annually	Budget Profit/loss statement
Clients' Profit	$ that individual clients earn	$ = Individual client gross income minus individual client expenses	Clients	Weekly Monthly	Clients' financial records
Return on Equity **(ROE)**	Ability of enterprise to generate sufficient income to be a worthwhile investment	% = Net profit divided by owner's equity	Shareholders Investors Public donors Enterprise Manager Clients	Quarterly Annually	Profit/loss statement Balance sheet

[1] *Financial Ratio Analysis of Micro-Finance Institutions*, the SEEP Network and Calmeadow, 1995, Pact Pubications, NY, NY.

EXHIBIT 8A: FINANCIAL PLANNING OBJECTIVES FOR SOCIAL ENTERPRISES

Type of Objective	What It Measures	How to Calculate	Primary Users	Reporting Period	Information Source
Current Ratio	Liquidity: how well the enterprise can meet its short-term cash requirements	X = Total of ***assets*** able to be converted into cash within one year divided by ***liabilities*** to be paid within one year	Shareholders Investors PO Business Advisor Enterprise Manager	Quarterly Annually	Balance sheet Cash flow
Quick Ratio	Liquidity: ability to pay current liabilities without relying on the sale of inventory	$ = Cash + accounts receivable divided by current liabilities	Shareholders Investors PO Business Advisor Enterprise Manager	Quarterly Annually	Balance sheet Cash flow
Sales Growth	Profitability: ability of the enterprise to make a profit through increasing sales	$ = Current year's (month's, quarter's) sales minus last year's (month's, quarter's) sales divided by last year's (month's, quarter's) sales	Shareholders Investors PO Business Advisor Enterprise Manager Marketing Manager	Monthly Quarterly Annually	Income statement Cash flow
Accounts Receivable Collection Period	Efficiency: ability of enterprise to collect its accounts receivable promptly	# of days = (Average accounts receivable divided by sales) times # of days in the reporting period (year, month, etc.)	Business Advisor Enterprise Manager	Quarterly Annually	Balance sheet
Inventory Supply	Efficiency: ability of enterprise to meet sales demand with available unfinished and finished stock	# of days = (Value of inventory divided by COGS) times # of days in the reporting period (year, month, etc.)	Business Advisor Enterprise Manager	Quarterly Annually	Balance sheet Profit/loss statement
Donor Dependency[2]	Show extent of dependency of enterprise on outside funds	% = Grants and Donations divided by ***average performing assets*** or ***average total assets***	Pubic donors Investors Business Advisor Enterprise Manager	Quarterly Annually	Balance sheet

Accounts receivable—money due from customers for products or services sold.

Accounts receivable collection period—number of days it takes for an enterprise to collect its accounts receivable. It is calculated as follows: number of days = (accounts receivable/sales) x number of days in the reporting period.

Assets—items owned by a company that are expected to generate cash. Examples include accounts receivable, inventory, and equipment.

Average performing assets (APA)—only the part of the assets used to support the business program[3]. Using APA is an appropriate measure when an enterprise is an early program phase under the auspices of the parent organization or implementing partner, or if after maturity it continues to share assets with another organization-i.e. building and land.

Average total assets (ATA)—calculated by summing the total assets in the balance sheet. ATA is an appropriate measure when all assets are used by the enterprise for its business activities.[4] It is the case when the enterprise is single purpose and assets are distinctly separate from another organization (parent organization, implementing partner, nonprofit).

Gross income—all revenue before deduction of any expenses.

Inventory supply ratio—the number of days the inventory will last given the rate of sales.

Liabilities—debts, or the obligations of a company to pay money to others (creditors, suppliers, payroll, etc.).

Return on equity (ROE)—expressed as a percentage that measures the ability of an enterprise to generate sufficient income to be a worthwhile investment. This is calculated by dividing net profit by owner's equity.

[2] Ibid., Donations and Grants Ratio.
[3] Ibid.
[4] Ibid.

Setting Targets for Each Financial Objective

After selecting the most appropriate types of financial objectives for your social enterprise, the next step is to set the targets for each one. Setting targets essentially means quantifying objectives with a specific number or percentage and tying them to a particular time frame. For example, to arrive at net profit/loss objectives, annual targets are sets for both revenue and expenses (exhibit 8B).

EXHIBIT 8B: NET PROFIT/LOSS

Year	1	2	3	4	5	6	7
Total revenue	$15,000	$45,000	$95,000	$145,000	$190,000	$215,000	$235,000
Total expenses	$205,000	$265,000	$280,000	$285,000	$270,000	$225,000	$185,000
Net Profit/Loss	($190,000)	($220,000)	($185,000)	($140,000)	($80,000)	($10,000)	$50,000

How to Set Targets

You can set the targets in one of two basic ways:

1. **Bottom up.** This approach follows the format in this manual and is the best method for new enterprises. Begin with marketing, operations, and human resource plan calculations found in the respective budgets, sales forecasts and production plans. Then total projected expenses and revenues to determine financial target. Evaluate this target. Is it achievable for the time period specified? (chapter 2 for a complete list of criteria for setting "SMART" objectives.) If not, recalculate original numbers in the marketing, operations, and human resource plans. Total them to derive the financial target again. Repeat until the optimal financial target is found. Note that all of the targets that feed into the financial target must also be achievable for the specified time period.
2. **Top down.** This approach can be used if you have at least one year of experience operating your social enterprise and historical records to reflect performance to date. Pick a "ballpark" target. Then work backward through the marketing, operations, and human resources plans to calculate what is required to meet that target. Adjust the target as needed to ensure it is achievable for the time period in question.

Whether you choose a top-down or bottom-up approach to establishing your social enterprise's financial targets, you must decide how far into the future to project the financial targets. There is no one right answer. Generally, the detailed targets should be set for one to three years into the enterprise's "financial future," and broader-stroke calculations should be consistent with the time it takes to reach financial viability, usually three to seven years barring country context and type of enterprise. Social entrepreneurs define financial viability in a variety of ways. For our purposes, a social enterprise is considered financially viable when it no longer requires external subsidies. It may still require loans or other investments to support its business operations, as many profitable private-sector enterprises do. A financially viable social enterprise is one that is able to secure necessary funds through regular, unsubsidized financial channels.

In most cases of subsidized social enterprises, financial viability is one of the financial objectives, which means that the financial targets should be calculated at least to the point when the enterprise reaches financial viability. It is important, however, to distinguish between overall financial objectives as stated in chapter 2 and financial targets that support achieving these objectives, which correspond to the time frame of your business plan.

For TARTINA Enterprise, financial viability is estimated to be realized in the seventh year of operation. Cost recovery and net profit/loss are the objectives that most directly indicate progress toward financial viability. By the end of Year 7, cost recovery is expected to be at 127 percent for TARTINA Enterprise. Since TARTINA's business plan is for one year, the cost recovery target of 10 percent is set for the first year of operation (see exhibit 8C).

EXHIBIT 8C: COST RECOVERY

Year	1	2	3	4	5	6	7
Cost recovery	10%	17%	34%	51%	71%	96%	127%

TARTINA clients wash up before beginning a production shift.

Exhibit 8D: Hints for Setting Targets

Financial Objective*	Guidelines for Setting	Targets Over Time
Budget Expenditure Pattern	Within 5% of projections. Most donors tolerate up to a 10% deviation from projected budget line items.	% deviation decreases. By the end of the subsidized period, any overexpenditures must be absorbed by the social enterprise. Unspent funds are returned to the donor.
Clients' Profit	Equal to or greater than what clients can earn in other income-generating activities.	Increase
Sales Growth	Look for steady increase. If costs and inflation are on the rise, then watch for related increases in your sales. If not, this is an indicator that your prices are not keeping up with costs.	Increase
Return on Equity (ROE)	Equal to or greater than what can be earned from the money (equity) if invested in alternative income-generating activities.	Increase
Current Ratio	A ratio of 2:1 is generally considered desirable. At least the value of the ***current assets*** must be greater than that of ***current liabilities***, which means that the social enterprise can meet its short-term cash requirements.	Increase
Quick Ratio	A ratio of 1:1 is desirable. This means that you don't have to rely on the sale of inventory to pay your bills.	Increase
Accounts Receivable Collection Period	30-90 days. The shorter the collection period the sooner cash is freed up for other uses.	Decrease
Inventory Supply	A low number of inventory supply days may mean a risk of running out of stock. A high number of days may mean the stock is not selling well. The "best" target is a balance between the two. Depends on the subsector the social enterprise operates in. Poor inventory management ties up cash.	Approach a balance between high and low numbers of inventory supply days

Current ratio**—**a measure of liquidity used as an indicator of an enterprise's ability to pay short-term debts. The current ratio is derived by dividing current assets by current liabilities.

Quick ratio**—**a measure of the relationship between the most liquid assets (cash, short-term securities, receivables and short-term investments) to current liabilities, used as an indicator of an enterprise's short-term liquiditiy.

Current assets**—**assets that are expected to be turned into cash within one year through the company's normal operations.

Current liabilities**—**liabilities due for payment in one year.

*Annual targets for a seven-year period for objectives: *Cost recovery, cost efficiency, and income per client* are detailed in chapter 2 of this manual and therefore are not reproduced here.

Setting Financial Targets

- ▲ Have a qualified staff accountant or financial manager participate in preparing this section.
- ▲ Arriving at financial targets can be a time-consuming and rigorous mathematical exercise; be sure to allow ample time for preparation and include key participants (chapter 1, Business Plan Framework, exhibit 1E).
- ▲ Begin by projecting the financial viability of your social enterprise; at what point in time will this occur?
- ▲ Use either the "top-down" or the "bottom-up" method to set targets for each of your financial objectives that correspond to targets in other business plan sections as well as support overall viability objectives.
- ▲ Recalculate targets for marketing, operations, and human resource plans, if necessary, until you are able to reach optimal financial targets.

Business manager, PO business advisor, program manager, finance and accounting staff

<u>**Financial targets are included in the Business Plan.**</u>

Evaluating Financial Targets

Setting financial targets helps you keep your social enterprise on track, serving to measure and evaluate incremental progress toward achieving objectives. Therefore, at the time of setting objectives, you will need to establish a schedule for evaluating progress toward financial targets.

Rationale:

Establishing an evaluation schedule at the beginning is important for several reasons:

- ✷ It brings the "M" of measurable down to earth by ensuring that you have identified useful targets that warrent the time and resources required to measure them.
- ✷ It highlights whether or not you have qualified personnel to do the job by assigning an evaluation task to qualified personnel.
- ✷ It helps human resource performance management by linking responsibility for financial target results to performance appraisals (chapter 7).
- ✷ It sets a platform for communicating results of financial target assessment, i.e. published information in newsletters or reports.
- ✷ It assists planning by considering which objectives/targets should be measured internally or externally during an audit.
- ✷ It incorporates cost implications in business plan budgetary projections.

Role of the Audit or Evaluation

There are two different types of audits: internal (which vary in frequency) and external (which usually are annual). The primary purpose of an internal audit is to check the systems of an organization and ensure that all internal controls are in place. The primary purpose of an external audit is to ensure that the financial statements of an organization present a true and fair view of its operations. External audits are generally a legal requirement for any social enterprise program. Sometimes donors also conduct audits of individual projects or grants. Any large implementing organization or social enterprise should have an internal auditor who reports directly to the board or, sometimes, the head of the organization. An internal auditor usually has some accounting qualifications but may not be fully qualified.
External audit firms are generally legally required in most countries to be managed by fully qualified accountants.
Auditors in many countries have a code of ethics that recommends they undertake their work with an attitude of "healthy professional skepticism," so expect your answers to be questioned at times.

Preparing an Evaluation Schedule

- ▲ Develop an evaluation schedule for internal and external audits that corresponds to the time frame of your business plan.
- ▲ Include information on how evaluations will be conducted, who will conduct them, and who will be responsible for oversight.
- ▲ Be sure to link responsibility for target results to job performance (chapter 7).

Evaluation Plan is included in the Business Plan appendix.

Social Enterprise Cost Structure and Financial Trends

By now you know that the difference between a social enterprise and a private business is that a social enterprise has two bottom lines—a social and a financial one—whereas the private business has only a financial one. Your social enterprise has to both build local capacity and create a viable business; the private company is only interested in increasing value for its shareholders. By the same token, social enterprises are expected to have returns (quantified in terms of social impact) and are answerable to their investors—donors.

Capacity-building and investment decisions are more dramatic for social enterprises than they are for private businesses, with returns coming later, normally much later, than what would be acceptable in the private sector. *Capacity building* involves extra costs for training and technical assistance. A social enterprise also bears the financial burden for social costs of executing its mission and serving a disadvantaged population. Referred to as ***comparative disadvantages***, these costs include: client inefficiency allowance, extra supervision time, above market wage/income, wastage, productivity compensation due to poor infrastructure (for programs in developing countries), extra time required for donor reporting, and money for social program activities. Capacity building demands investment money, whereas comparative disadvantages require ***subsidies***. Regardless of the nature of costs, viability is a condition of a social enterprise, not an exception. You will not be able to satisfy your impact objectives if you cannot achieve viability.

The next section distinguishes between investment capital and subsidies in social enterprise programming. A good social enterprise business will need capital for capacity building to achieve viability, whereas a bad one (a nonviable one) will need subsidies to sustain its operations. Provided that you have selected a solid business idea within a hospitable environment with a sufficiently large market in which to launch your social enterprise (see chapters 3 and 4), revenue streams will be close to those of a private business. Operating costs, however, are much higher for social enterprises, which have to cover capacity-building and comparative disadvantages costs before they break even.

As development practitioners can attest, capacity building per se is hard to account for. Nonprofit professionals have tried various methods to quantify capacity building, including logging numbers of people trained or documenting skills development. Save the Children's view is that capacity is the acid test of social enterprise success and is measured by achieving business objectives (chapter 2) and financial targets outlined in this chapter. Benchmarking progress toward reaching targets and objectives over time indicates trends.

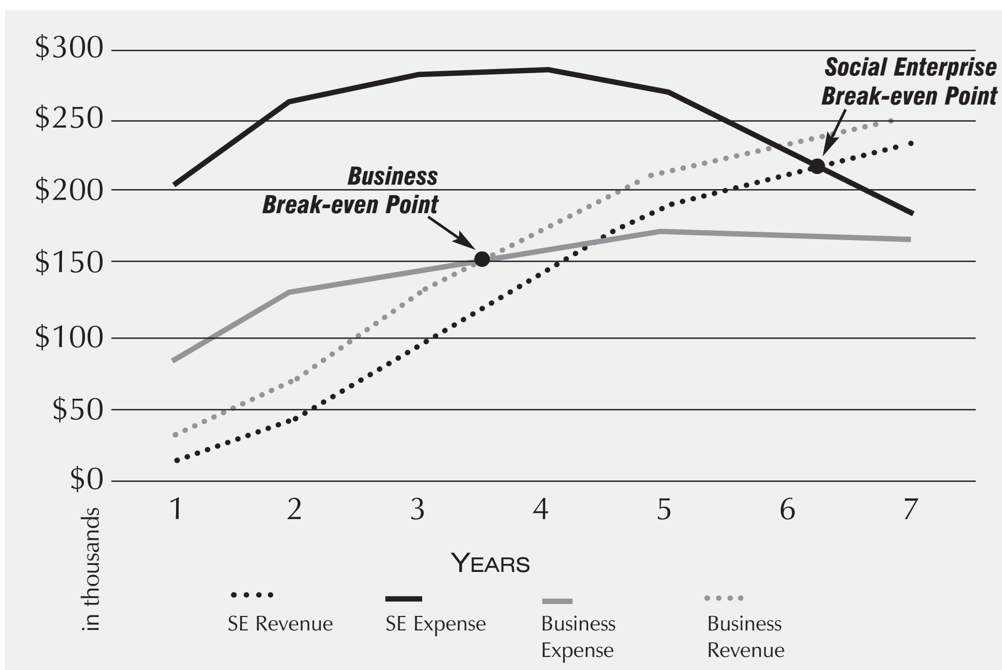
Comparative disadvantages—factors within a social enterprise such as expensive capacity building, compensation for loss in productivity and materials, and costs of social programs that make it difficult to compete with private sector competitors due to substantially higher costs.

Subsidies—grants or gifts by private individuals, governments, or foundations aimed at assisting a venture reputed to be beneficial to a target population or the public.

It is important to watch these trends closely; they can act as a warning system and flag a problem endemic among nonprofits business interventionists—understanding the difference between a subsidized social enterprise and a variable one. A common shortcoming of social enterprise professionals is that they often readily accept that costs are high. While this may be partly true, if trends show a continued deviation from projections, that is an indication that structural problems are present: Either the cost structure is too high or revenues are too low to support the business without continued subsidy. What this means is that the extra costs are not due to capacity building but, rather, the enterprise is not fully in the market and without adjustment will be doomed to failure. Ultimately, if capacity building is accomplished successfully the social enterprise will be able to sustain its operations after five to 10 years without external aid other than what is provided by investors or creditors, as in the case of any private business.

Exhibit 8E shows this relationship using projected profit/loss trends for TARTINA compared with a similar private business. The example gives a visual representation of numeric projections. The balloon-like shape clearly portrays the high capacity-building costs inherent in social enterprises, but not present in private businesses. After the enterprise achieves viability, though revenue between the two is close, cost structures for social enterprises continue to be marginally higher than those of a private business.

EXHIBIT 8E: FINANCIAL TRENDS



PO business advisor, business manager, finance and accounting staff

Projecting Financial Trends

▲ Using the graphics feature in a spreadsheet program, project the trend lines of your financial targets and objectives.

<u>Social enterprise trend projections are included in the Business Plan.</u>

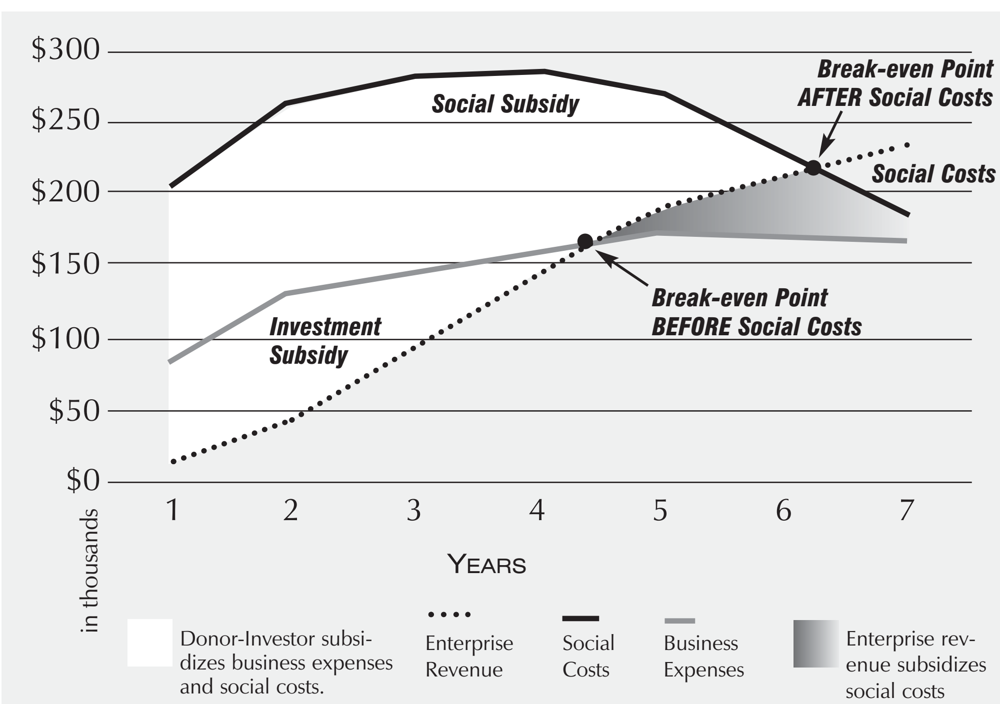
Investment and Subsidies

In the private sector investments provide the necessary capital to start and grow a business until it is profitable. Similarly, a social enterprise requires investment, yet it also needs a subsidy to cover social costs. Donors and private investors expect a return on their money, and like business investments, subsidies to social enterprises are only warranted if their costs can be justified. Simply put, will they realize a financial or a social return?

Subsidies represent a real cost; therefore, you are accountable to your donors to demonstrate a quantifiable return. For investment expenses, realistic financial projections must show an eventual break-even point (within an acceptable time frame) as well as evidence that social impact targets (chapter 2) are met, ensuring that investor money is not being squandered. When investors are dissatisfied with a business' performance, they withdraw their support, evoking the "survival of the fittest" rule in the business world. By the same token, auto-regulation of social enterprise programs is the power of the donor to pull the plug if your program is underperforming both in financial and social impact terms.

Social subsidies are more complicated and difficult to quantify (see next section Quantifying Social Costs) than investments. As mentioned, capacity building costs are considered normal investment costs, though they tend to be higher for social enterprises than in private business due to the low skills or special needs of the populations these enterprises serve. Subsidies, on the other hand, offset losses in productivity and expenses related to running social programs. These costs create disparity between social enterprises and their competitors in the private sector because they substantially increase enterprise costs, making it difficult to compete, or measure business performance against industry standards. (exhibit 8F.)

Exhibit 8F: Investment and Subsidy



The question is: Which costs should you subsidize with donor money and which ones should you try to cover with revenue? The structure of your organization, requirements from current donors, internal management decisions, the nature of the enterprise, and financing opportunities determine how to treat certain costs. For example, Save the Children segregates its overhead and technical assistance costs from enterprise operations, considering them a temporary but necessary expense to finance capacity building. SC assumes that its costs will be fully subsidized for at least the first donor funding cycle of the enterprise program. Start-up costs of initial fixed assets and capital are fully subsidized by donor monies. SC does not expect that the social enterprise will be able to recover and repay initial investments like private business. Operating deficits are subsidized on a declining basis to fill the gap between revenues and capacity-building, loss compensation and social program expenses. Unlike a private business that may borrow funds or use venture capital to finance ***working capital*** and operating costs prior to breaking even, social enterprises are not required to recuperate these costs and reimburse donors. Lastly, some social costs will need continued subsidy. Depending on the social enterprise's ability to generate revenue, social program mix and donor funding priorities, social subsidies will either be provided internally from enterprise revenue or externally from donor support.

Working capital—the excess amount in current assets over current liabilities. Working capital is the money a business uses to run its operations and in accounting is a measure of the enterprise's ability to service its financial obligations.

Exhibit 8G Social Enterprise Financing Structures illustrates how subsidies work in social enterprise programs. Although all money is ***fungible***, subsidy must be recognized separately from income generated by the enterprise in financial statements and budgets (see following sections on preparing financial statements). Additionally, allocating subsidies coupled with the viability of your social enterprise have a direct impact on your fundraising and financing strategy (see Resource Acquisition Strategy).

Fungible—being of such a nature that one part or quantity may be replaced by another equal part or quantity in the satisfaction of an obligation.

TARTINA Clients clean up after their production shift.

EXHIBIT 8G: SOCIAL ENTERPRISE FINANCING STRUCTURE

PARENT ORGANIZATION BUDGET SALARIES TA/TRAINING OPERATING OVERHEAD	**WHOLLY SUBSIDIZED** (FOR DURATION OF THE PROGRAM)
ENTERPRISE BUDGET START-UP COSTS	**WHOLLY/PARTIALLY SUBSIDIZED** (ONE TIME) (IF MATCH)
ENTERPRISE BUDGET SALARIES TA/TRAINING OPERATING COSTS & OVERHEAD	**SUBSIDIZE DEFICIT** (DECLINES OVER TIME, REPLACED BY REVENUES AND INVESTOR/CREDITOR CAPITAL)
SOCIAL COSTS CAPACITY BUILDING LOSS COMPENSATION SOCIAL PROGRAMS	**DONOR OR PARENT ORGANIZATIONS SUBSIDIZED/FINANCED BY ENTERPRISE REVENUES** (POSSIBLE TO RECEIVE GRANTS FOR SOME PROGRAM COSTS DESPITE PROFITABILITY OF ENTERPRISE)

USE OF INCOME

Until the enterprise actually breaks even, revenues simply represent a decrease in loss, but they should be acknowledged and accounted for differently from subsidy in financial statements (explained later).

There are a variety of ways in which social enterprise revenues can be handled:

Prior to breaking even:

- First, revenues should be used to cover variable and production costs (reflected in cost of goods sold in the profit and loss statement, which gives you gross margin).
- Second, revenues in excess of variable costs should be used to cover the fixed costs of the social enterprise (or the operating deficit for salaries and overhead costs).

- Third, revenues are used for capital assets, such as equipment investments, that will generate additional revenue for the enterprise.
- Fourth, revenues used for pay raises to workers, clients, employees in-step with cost of living increases and job performance promotions.
- Fifth, revenues are contributed to a revolving loan fund, savings accounts, or insurance schemes for the microentrepreneurs operated by the social enterprise.
- Sixth, revenues applied to financial costs of borrowed capital (interest on loans) to finance business operations and growth.

After viability is achieved:

- Use revenues for profit sharing via bonuses, dividends or increases in base salaries or wages of workers, clients, employees to increase their overall economic security.
- Use revenues to finance the expansion phase of the social enterprise.
- Invest revenues in diversifying enterprise business or other income-generating activities in the formal or informal markets.
- Use revenues to cross-subsidize other sector activities or add new capacity-building programs, such as literacy, that may have been too expensive to include in the immature business.
- Invest in an endowment or long-term securities to generate income for social programs.

Remember to consult the enterprise's program donor(s) early on this matter, as they are likely to have their own regulations and preferred approach. An agreement needs to be reached before start-up of the program and the appropriate financial instruments prepared.

How TARTINA Dealt With Revenues

TARTINA negotiated with its donor that it would use enterprise project revenues to cover fixed costs of the enterprise. This was considered the best strategy, as it most directly contributed to the cost recovery and financial viability objectives. In practice, this approach required that TARTINA plan in advance which fixed costs the revenues would cover. TARTINA chose promotional and sales staff salaries for this purpose, as these were expenses with some degree of flexibility. That is, if TARTINA were unable to reach its revenue targets, the budget line items projected to be covered by the revenues would need to be scaled back. As well, TARTINA's revenues would cover depreciation of the enterprise project's vehicle, as this was an expense that the donor could not subsidize because of its own regulations.

Business manager, accountants and finance staff, PO business advisor, partner program manager

Planning for Revenue

▲ Write a few lines on how you plan to use enterprise revenues.

Revenue information is included in the Business Plan with your trend projections (previous section).

Quantifying Social Costs

Rationale:

Running a social enterprise involves additional costs not incurred by traditional businesses. Directly employing disadvantaged people in your work force who face constraints to normal employment or providing services to them to bring their products to market when access is otherwise not possible are expensive business propositions. Yet, as a social enterprise you are bound by your mission to increase this population's economic security and quality of life while operating with reference to a financial bottom line. Thus, social enterprise managers must be able to make informed decisions with respect to both the business and the social programs. One device for effective decision-making is to segregate the costs of these distinct functions that run simultaneously.

Distinguishing social costs from business costs has express advantages. Concerning the business side, knowledge of the social enterprise's profitability shapes every strategic and operational decision made by management. It provides the means to assess the enterprise's market position and craft a competitive strategy. Furthermore, separating these costs permits social enterprise accountants to prepare financial statements comparable to those of similar private businesses, enabling managers to measure enterprise performance against competitors and industry standards. This is important because it informs management about costs that may be reduced or investments made to increase enterprise profitability and competitiveness. Moreover, understanding the social enterprise's financial performance vis-à-vis its for-profit colleagues provides information for strategic decision-making on issues such as pricing, expansion, market entry, product development, exit, etc.[5]

Similarly, quantifying social costs informs decision-making regarding social programming. Understanding social cost allocations allows managers to measure the effectiveness of achieving social impact objectives. Tracking expenses over time informs whether costs are rising or declining to meet objectives. Evaluating program cost effectiveness helps determine which social costs yield the largest benefit on social impact. Likewise, when costs are separated, social cost figures can be analyzed for their impact on business performance. This enables managers to delineate

---

[5]*Investor Perspectives*, "Quantifying Social Costs: A Case Example from Rubicon's Buildings and Grounds Business," Kim Starkey, 2000, Roberts Foundation, SF, CA.

which social costs can be considered investments rendering a return via increased revenues, and which are subsidized costs inherent in achieving a social mission and never yield financial benefit to the business. (exhibit 8F, Investment and Subsidy.) Making this distinction helps managers plot their resource acquisition strategy (see Resource Acquisition Strategy at the end of this chapter).

Enterprise production/operations and business managers, accountants and finance professionals, supervisors, social program directors, PO business advisor

Quantifying social costs is a complicated and imprecise science[6] that requires developing consistent methodologies suitable for your social enterprise.

▲ Find the blank table **Quantifying Social Costs** provided in *The Workbook* to use as a template, or create your own.

▲ *Step 1*—brainstorm the types of social costs that are significant for your social enterprise and assess the likely cost magnitude of each one. For example, if you have clients in your labor force, and labor is one of the largest components of your enterprise's cost base, then it is likely your most significant costs are related to employee inefficiencies or additional supervisory time.

▲ Fill out table based on conclusions.

▲ *Step 2*—outline each methodology that could be used to identify social costs and pinpoint its methodological challenges. Three examples of methodology follow: 1) **time**—approximately 30% of the manager's time is devoted to "extra" tasks necessitated by the challenge of managing the enterprise's disadvantaged labor force; thus 30% of the manager's salary and benefits would be quantified under social costs. 2) **Lost income** (+ time)—poor health of clients constitutes 25 sick days and 20% loss in productive days or income not earned. Therefore, the percentage of lost productive days over and above the industry standard (use for example 3%), which would be 17% lost revenue, is allocated to social costs along with the costs of sick day benefits of 20 days over and above industry standard (for example 5 days). 3) **Wage premium**—social enterprises pay livable wages to a population that may not have such a high earning potential. Compare salaries, wages or piece rates across your industry. Use published industry statistics if available, or contact your competitors, suppliers, buyers to determine standard pay scales. Deduct the social enterprise "premium," the amount above median industry standard rate.

▲ *Step 3*—decide which social costs to include in the analysis by weighing methodological challenges and the estimated magnitude of each social cost. You will probably not quantify all of the social costs that are relevant to your enterprise. Some costs will be eliminated on the grounds that they are either financially insignificant or the methodological challenges for determining them are too great.

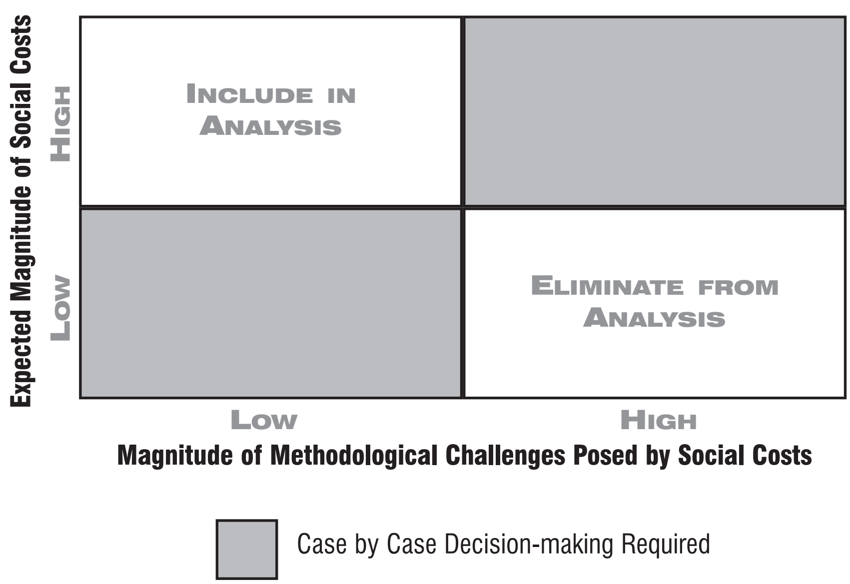
▲ *Step 4*—execute your methodology and translate social costs into dollar amounts or use local currency. Pay particular attention if your methodology is based on percentage, not to confuse percentage and dollar values. Methodology should be applied to accounting periods, and quantified monthly, quarterly and annually.

---

[6]Ibid., steps to quantifying social costs given in exercise.

Social cost information will be used for two purposes later. First, to define both bottom lines in financial terms when you prepare a profit and loss (income) statement for your social enterprise (see Adjusting the Profit and Loss to Include Social Costs). And second, to provide useful decision-making information for your resource acquisition strategy (see Resource Acquisition Strategy).

EXHIBIT 8H: HOW TO DECIDE WHICH SOCIAL COSTS TO INCLUDE IN THE ANALYSIS[7]



[7]*Investor Perspectives*, "Quantifying Social Costs: A Case Example from Rubicon's Buildings and Grounds Business," Kim Starkey, 2000, Roberts Foundation, SF, CA.

EXHIBIT 8I: QUANTIFYING SOCIAL COSTS[8] FOR TARTINA

TYPE OF SOCIAL COST	DEFINITION	MAGNITUDE OF COST	SUBSIDY OR INVESTMENT	FUNDED BY (AFTER INITIAL INVESTMENT)
CAPACITY BUILDING	**Skills training of disadvantaged work force.**			
Hard Skills Training	Time and costs for transferring hard skills (production techniques, packaging, machine use, etc.) to work force.	High	Investment	Revenue/ Grants
Soft Skills Training	Time and costs of interpersonal skills, accountability, etc).	Medium	Investment	Revenue
LOSS COMPENSATION	**Loss in productivity and materials due to disadvantaged nature of work force.**			
Allowance for Inefficiency	Time needed to complete job due to low skills, illiteracy, disabilities, of disadvantaged work force.	High	Subsidy	Revenue
Extra Supervisory Time	Time for supervision, counseling, on-the-job training of disadvantaged work force.	High	Subsidy	Revenue
Wage/Income Premium	The difference between social enterprise rate and industry standard for level of skills in work force.	Medium	Subsidy	Revenue
Wastage	Cost of wasted materials due to employment of work force in training.	Low	Subsidy	Revenue
Illness/Family Problems	Loss of work time due to poor health, emotional or family problems.	Medium	Subsidy	Revenue
Poor Country Infrastructure/Inefficiencies (Developing country context only)	Time for inefficiencies and infrastructure problems, costs for building extra infrastructure.	Medium-High	Subsidy	Revenue

[8]Ibid., Table modified. Assumes cost structure after start up phase is complete.

TYPE OF SOCIAL COST	DEFINITION	MAGNITUDE OF COST	SUBSIDY OR INVESTMENT	FUNDED BY (AFTER INITIAL INVESTMENT)
SOCIAL PROGRAM COSTS[9]	**Integrated social programs aimed at assisting clients or requirments of parent organization.**			
Donor/Parent Organization Activities and Fundraising	Time for donor visits, reports, fundraising, parent organization events, meetings that detract from enterprise productivity.	Medium	Subsidy	Grants/parent organization
Counseling, Job Coaching	Costs for on-the-job support and emotional stability.	Medium	Subsidy	Grants/ revenue
Other Vocational or Education Services	Costs for training to enhance clients' employability and independence outside of enterprise program.	High	Subsidy	Grants/parent organization
Food, Housing, Clothing, Health Care	Costs that meet basic/special needs of clients other than economic ones.	High	Subsidy	Grants/parent organization

[9]TARTINA does not integrate business and social programs within its enterprise structure, and therefore does not incur the "Social Program Costs" given in this chart. Thus, information on the magnitude of costs, whether it is a subsidy or an investment, and who underwrites these costs are given generically—based on average expenses of integrated social enterprise programs.

Financial Tools

An essential part of the social enterprise's financial plan is preparation of four key financial tools, namely:

- **Budget—**details anticipated enterprise expenses and income.
- **Profit/loss statement—**measures the profitability of an enterprise over a period of time.
- **Balance sheet—** provides a "snapshot" of the enterprise's financial position at a given point in time.
- **Cash flow statement—**explains how cash was both generated and spent over a period of time.

Financial Control

Financial statements are an important control mechanism and should be produced regularly. They should not just be viewed as something that is produced once a year for audit and registration purposes. The different parts of financial statements are intrinsically linked. For example, if you see your receivables increase, you might expect your cash to decrease and vice versa. If you see your inventory and receivables increase drastically, you are probably about to have significant cash flow problems. The effects of good or weak internal control systems will show up in your financial statements. As a social enterprise you must be strict about collection of receivables or you will have no cash left. There's no quicker way to destroy an enterprise than to be slack in collecting what is owed to you. And pay everything you owe to others early! You must know each week what is due from credit sales and take firm action. Every dollar tied up in receivables (or excessive inventory) is a dollar that cannot be used to expand or maintain your enterprise. Be strict on controls around cash. Imagine that it's your own money. You wouldn't allow your personal debts to go uncollected, or pay too much for supplies because you didn't have time to walk 200 meters farther to a cheaper shop, or leave your own money lying around in an unlocked drawer rather than in a safe. But people frequently do these things with money that belongs to an enterprise.

The last three tools are also referred to as financial statements in accounting and financial literature.

Financial tools represent the financial strength and performance of a social enterprise and are used for planning, evaluation, and control purposes by the various enterprise actors. There is some debate about which financial tools are most important. Proponents of balance sheets advocate their use over other financial tools because they represent the true value of the enterprise. Others prefer profit and loss statements, as they indicate whether your enterprise is making or losing money. Our experience shows that social enterprises most often falter in cash management, hence significant explanation is given to the subject of cash flow.

All financial tools are linked and should be used together in order to fully understand the financial position of the enterprise (exhibit 8K: Interrelationship between Financial Statements for Social Enterprises). Without these tools, you will not be able to prepare the enterprise's financial targets or measure its progress against these targets. Exhibit 8J, Financially Statement Overview, gives an overview, of the purpose, time frame, and main users for each financial tool.

EXHIBIT 8J: FINANCIAL STATE OVERVIEW

Tool	What It Tells You	Time Frame for: Planning	Time Frame for: Evaluation	Who Uses It
Profit/Loss Statement	How much the enterprise is making or losing.	Annually	Monthly Quarterly Annually	Shareholders, Public donors, PO Business Advisor, Enterprise Manager, Entrepreneurs
Balance Sheet	Financial picture of the enterprise as of a specific date. Lists assets, liabilities, and equity.	Annually	Quarterly Annually	Shareholders, Public donors, PO Business Advisor, Enterprise Manager
Budget	All of the expenses of the social enterprise (profit/loss statement) and all relevant expenses of the PO.	Annually	Quarterly Annually	Public donors, PO Business Advisor
Cash Flow Statement	Indicates cash surplus or shortage for enterprise operations. Shows all inflows and outflows of cash in the enterprise.	Annually	Weekly Monthly Quarterly Annually	PO Business Advisor, Enterprise Manager

Profit and loss statement—financial statement that summarizes the amount of revenue earned and expenses incurred by a business entity over a period of time; also called an ***income statement***. In nonprofit accounting, the profit and loss statement is sometimes referred to as the *statement of activity*.

Balance sheet—a financial statement that shows assets on the left side and liabilities on the right. A balance sheet gives an overview of a company's financial position at any given point.

Budget—a financial plan based on estimates of expenditures and revenues for a period of time.

Cash flow statement—a financial document that reports information about cash receipts and cash payments during an accounting period. The cash flow statement segments cash sources and uses into "operating", "investing" and financing" categories. It is generally prepared for the same period as the profit and loss statement.

Costs of goods (COGs) sold— Costs of inventory sold during an accounting period by the selling enterprise. COGs include all costs to make a product or render a service: labor, raw materials, operations, factory overhead, etc. It is important for social enterprises to list costs of goods sold in their income statement.

Gross profit—shows the value that an enterprise is earning over the cost of the merchandise sold **(costs of goods sold)**. Gross profit is calculated by subtracting costs of goods sold from total sales. It is called gross profit because other expenses still need to be deducted in order to arrive at net profit.

Operating expenses—the costs of the selling and administrative activities of a business. Operating expenses are reported in the income statement and are usually categorized as selling and general administrative expenses.

Net profit—what remains after all expenses have been subtracted from revenue; also referred to as *net income.*

Net worth—also called owner's equity, net worth is equal to assets minus liabilities. It represents the value of the enterprise.

Fund Accounting—a concept particular to nonprofit organizations and government agencies. Financial records must be maintained for each program that receives contributions (in the form of grants and donations) designated to support a specific program. Each set of records is called a "fund" and is considered a separate accounting entity with its own financial statements.

Pro forma—a projection or estimate of what may result in the future from actions in the present. Pro forma budgets and financial statements estimate business performance results based on certain assumptions.

Exhibit 8K: Interrelationship Between Financial Statements for Social Enterprises

Profit/Loss Statement	**Change in Balance Sheet**
Sales	Increase in accounts receivable; decrease in inventory
Less: ***Costs of goods sold***	Decrease in inventory
Equals: ***Gross profit***	No change
Less: ***Operating expenses***	Increase in accounts payable, decrease in cash, or decrease in prepaid expenses
Equals: ***Net profit*** (or loss)	Increase in retained earnings for profit, or decrease in retained earnings for losses
Plus: ***Subsidy***	Increase in donor contribution (net worth)
Balance Sheet	**Change in Cash Flow Statement**
Increase in assets (use)	Decrease in cash
Decrease in assets (source)	Increase in cash
Increase in liabilities (source)	Increase in cash
Decrease in liabilities (use)	Decrease in cash
Decrease in ***net worth*** (use)	Decrease in cash
Increase in net worth (source)	Increase in cash

Rationale:

A good accounting system and financial statements are the basis of a sound enterprise. Do not rely on donor program reports or ***fund accounting***, which only tell you in cash terms how much you have spent on a particular line item during a month, quarter, or year. Donor project reports will tell you almost nothing about the overall health of your enterprise, nor will they assist you in making key decisions. For this you need standard financial statements as used in the business world. They will enable you to compare your enterprise with other enterprises. You are also far more likely to be well received by the local bank manager when your enterprise one day needs a cash-flow loan.

Guidelines for Preparing Financial Tools

- **Begin with projected financial statements and budgets.** Projected, also called ***pro forma***, financial statements, forecast future expenses and income. Pro forma financial tools provide the starting point for your social enterprise based on educated estimates.

- **Base projections on historical information or actual costs.** Use cost information either from past experience (if yours is an existing enterprise) or from research on market prices.

- **Clearly state the assumptions behind your projections.** This helps you think through the logic and basis for your projections, and if you discover that your projections are off, you can revisit the assumptions to verify whether they are still valid. Some examples for TARTINA include 12 gourdes per marmite for peanuts (based on last year's average prices plus a minor adjustment consistent with inflation) and $15,758 in annual pay for a Marketing Manager based on low-end competitive rates for the same job in the private sector.

- **Use the appropriate level of detail in your financial statements.** "Appropriate" refers to information that is important for users of financial statements for analytic and decision-making purposes. This may mean preparing consolidated statements that give financial information in summary form for external users, such as donors and investors, and more detailed statements for internal use by enterprise managers.

- **Reconcile projected financial statements with actual performance.** Report projections against actual performance. Reconciling differences quarterly or monthly not only helps enterprise managers verify whether they are on track with their estimates but signals problem areas before they become catastrophic. Finally, using this approach systematically should increase accuracy of projections as the enterprise matures.

- **Set up a standard accounting system.**[10] Whether it's an accrual or a cash system (see box), a social enterprise should use an accounting system that generates the same financial reports as those used in the private sector. Often nonprofits use simplified cash systems or structure their accounting to respond to donor reporting requirements, which may leave out information essential for financial analysis.

Accrual and Non-accrual (Cash) Accounting Systems

One of the tensions between the business and nonprofit worlds is which accounting system to use. The nonprofit world tends to use ***cash accounting***. The advantage of this is simplicity: Your financial statements reflect exactly what you have paid out in cash or by check. Some donors also require cash accounting. The business world generally uses ***accrual accounting***, which in fact is a legal requirement in most countries. Why? Well, consider a social enterprise that paid its rent of $2,000 for calendar year 1998 on Jan. 1, 1998, and that paid its rent of $2,000 for calendar year 1999 on Dec. 31, 1998. Accrual accounting would show rent of $2,000 in both the 1998 and 1999 financial statements because that is the correct amount relating to each year. Cash accounting would show a rental expense of $4,000 in the 1998 financial statement and nothing in 1999—a clear distortion of the picture. The only accurate way to evaluate financial performance month by month or year by year is to use accrual accounting.

Accrual Accounting—a practice of accounting whereby revenues are accounted for in the period in which they occur and expenses recognized when they are incurred, rather than when a cash payment is made or received. Accrual accounting gives a realistic picture of the enterprise's financial position by recording the effects of financial transactions on the social enterprise regardless of when cash is received or paid.

Cash Accounting—a practice of accounting whereby revenues and expenses are recorded when cash is paid and received. Cash accounting is straightforward and is often used by very small businesses; however, it can overstate or understate financial position of the enterprise depending on when a cash payment is made or received.

[10]The topic of social enterprise accounting systems is complex, particularly as it relates to the relationship between the enterprise and the parent organization. SC suggests that you consult with a private sector accountant, tax attorney and an MIS specialist before setting up a social enterprise accounting system. Recommended reading on this subject can be found in *Investor Perspectives*, "Accounting Issues in Social Purpose Enterprise," Cynthia Gair, 2000, Roberts Foundation, SF, CA.

Let Technology Be Your Friend

Nowadays there are many good off-the-shelf accounting packages available, so don't reinvent the wheel unless you have to. Try to choose one that has good technical support in the country and, if you have donor grants, one that can deal with fund accounting (separating the funds of different donors). Powerful spreadsheet programs such as Excel can also assist you with various financial tasks. But remember the old adage of garbage in, garbage out. Technology is no substitute for having a good, solid manual system underneath that feeds accurate information to your computer.

There are also more specialized accounting/financial management software packages that automate a number of functions, such as inventory management and ordering. Spreadsheet or software macros should link to financial statements.

- **Use technology to prepare financial statements.** The days of the abacus are long gone: Social enterprise managers need to embrace technology to be able to react quickly. Relying solely on a calculator means the enterprise won't have a chance of competing.
- **Be clear on tax implications for your social enterprise.** There are only two certainties in life: death and taxes. Even nonprofits are liable for various taxes, such as property, payroll, etc. The best way to understand what taxes the enterprise does or might owe is to consult a good lawyer and/or accountant. It's money worth paying upfront to avoid huge liabilities later.
- **Inventory valuation.** Select a system for valuing inventory (see box) that is appropriate for the type of business. Inventory valuation has an impact on the bottom line and is frequently overlooked by social enterprise practitioners.
- ***Depreciation method.*** Use a standard method of depreciating fixed assets suitable for your enterprise (see box on next page).

Average cost— a method of inventory valuation that assumes inventory sold during the period was purchased at the average cost of all inventory available for sale.

Inventory Valuation

The valuation of inventory is one of the most important parts of an organization's financial statements, as it has a direct effect on profit (via cost of goods sold). Inventory is usually valued at the lower of cost or net realizable value, i.e., the price you would receive if you sold it. With the exception of a few commodities that increase in value with age (whiskey and wine), the net realizable value of many commodities decreases over time as they become obsolete or their shelf life ends and value may therefore be lower than cost. Finding the exact cost of each unit of a commodity is obviously almost impossible if there are hundreds, so three main methods are used: FIFO, LIFO, and average cost method. FIFO—first in, first out—assumes that the oldest units are sold first and that remaining units are valued at the most recent prices paid or production cost incurred. FIFO is the most commonly used and accurate method of inventory valuation. LIFO—last in, first out—assumes that the most recent additions to inventory were sold first and therefore values inventory at older prices. LIFO is not often used. The ***average cost*** method simply takes an average of purchase prices or production costs for a commodity; its advantage is simplicity. Generally an organization should use FIFO unless there is a good reason not to.

Depreciation

Why depreciate? Let's imagine you purchase a vehicle that has an estimated useful life of five years. It makes sense to spread the cost of the vehicle over the five years it is used in the social enterprise rather than take the whole charge in one year, even though many donors would prefer that it be charged in one year for their accounting purposes. In business accounting, depreciation allows you to match the cost of assets with the revenues produced by them. There are two main methods: declining balance and straight line. Most businesses use straight-line depreciation for its ease. Thus, for the vehicle you would divide the purchase price (say $18,000) by its useful life (say five years or 60 months), and the depreciation charge would be $3,600 per year or $300 per month. However, this may not be that accurate for a vehicle, which typically loses 20 percent of its value the moment it is driven out of the showroom. It might be more accurate to take a depreciation charge of 30 percent of the net value of the vehicle each year. For Year 1 the charge would be $18,000 x 30% = $5,400, and for Year 2 it would be ($18,000 – 5,400) x 30% = $3,780 and so on. The main difference between the methods is that straight line is easier, the asset is fully depreciated in a certain time period, and the charges are equal each year. With declining balance, you have higher charges in earlier years and lower charges in later years. Generally, you should use the straight-line method unless it seems very inaccurate.

Depreciation—the decrease in the value of equipment from wear and tear and the passage of time. Depreciation is recorded as an expense that allocates the cost of the asset over the time it is expected to generate income.

Information Flows

Perhaps you are wondering where financial statement information comes from. This is a good question. Remember that in previous chapters the indicated information you would use in the financial section of your business plan. Exhibit 8L shows how the information you compiled earlier will be used to prepare your financial statements and budget.

Sales planning with sales team.

EXHIBIT 8L: FINANCIAL INFORMATION FLOWS

Information Used in Financial Plan	Represented in Financial Statements	Line Items
Strategic Frameworks, Chapter 4		
Seasonal Factors	Cash flow projections Profit/loss statement	Sales, COGS, operating expenses, sales, marketing
Financial Characteristics	Cash flow projections	Sales, returns, COGS, commissions, salaries
	Profit/loss statement Break-even	Sales, COGS, operating expenses Sales price (not a line item)
Marketing, Chapter 5		
Marketing Vehicles	Cash flow projections	Operating expenses
	Profit/loss statement Marketing budget Cash flow projections	Marketing and advertising All—related to promotion Operating expenses
No/Low-Cost Promotion	Profit/loss statement Marketing budget	Marketing and advertising All—related to promotion
Sales Plan + Structure	Profit/loss statement	COGS, sales or marketing, commissions, gross sales
	Cash flow projections	Cash sales, accounts receivable
Marketing Budget	Social enterprise budget	Marketing costs: salaries, benefits, payroll tax, commissions
Operations, Chapter 6		
Facilities	Profit/loss statement	Rent, utilities, maintenance, depreciation
	Cash flow projections Balance sheet	Operating expenses, other expenses Fixed assets, depreciation
	Social enterprise budget	Rent, building maintenance
Production	Profit/loss statement	COGS (inventory), salaries, benefits, payroll tax
	Cash flow projections	Operating expenses
	Production budget	All production expenses
	Break-even Social enterprise budget	Variable & fixed costs of production Raw materials, factory overhead, labor, salaries, benefits, payroll tax
Equipment	Profit/loss statement	Depreciation, equipment rental, furniture and equipment
	Balance sheet	Fixed assets, depreciation
	Cash flow projections	Operating expenses, equipment purchase
	Social enterprise budget	Fixed assets: production equipment

Cash flow projection—a forecast of the cash a business anticipates receiving and disbursing over a given span of time, frequently one month. It is useful in anticipating the cash portion of a business at specific times during the period projected.

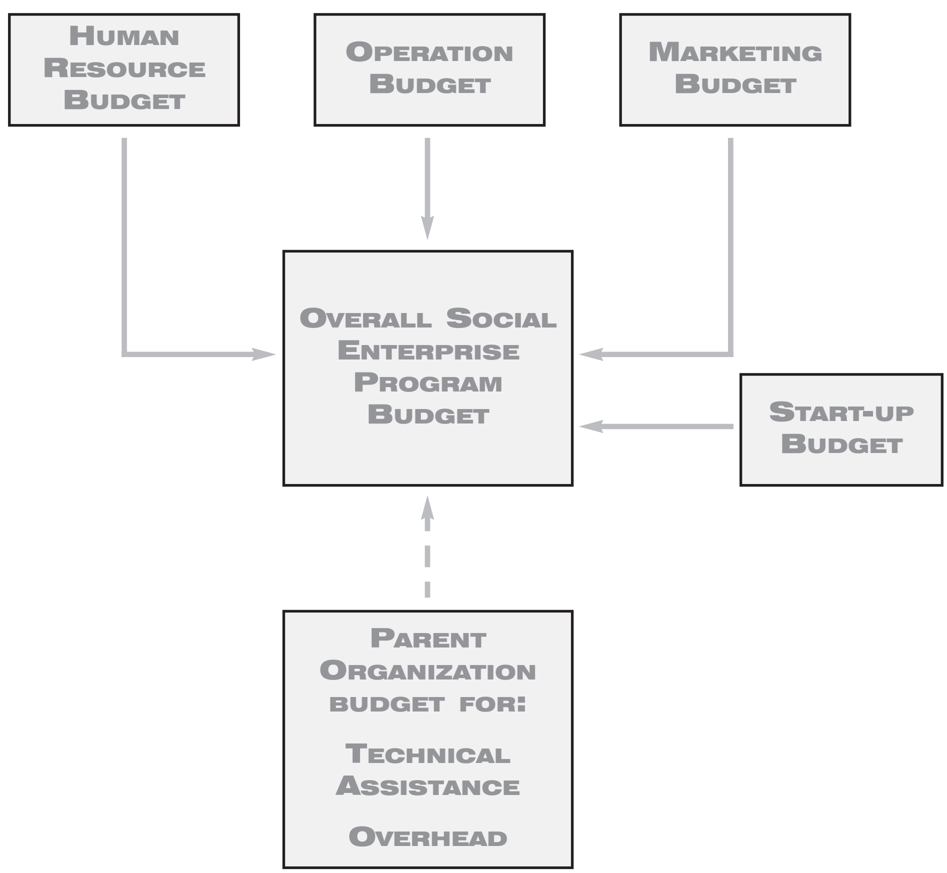
Information Used in Financial Plan	Represented in Financial Statements	Line Items
Research & Development	Profit/loss statement	Operating expenses, allocated salaries, or R&D
	Social enterprise budget	R&D, consultants, materials
Human Resource Plan, Chapter 7		
PVO Staff	Social enterprise budget	Salaries, benefits, payroll tax
Enterprise Staff	Social enterprise budget	Salaries, benefits, payroll tax
	Income statement	Salaries, benefits, payroll tax
	Cash flow projections	Operating expenses
Recruitment Plan	Income statement	Salaries, benefits, payroll tax
	Cash flow projections	Salaries (projections for new hires)
Incentive Programs	Income statement	Sales commission
	Cash flow projections	Operating expenses
Capacity Building	Income statement	Training materials and services, legal and professional services
	Cash flow projections	Operating expenses
Financial Plan, Chapter 8		
Start-up Costs	Profit/loss statement	First month's operating expenses allocated to relative lines
	Balance sheet	Current assets, fixed assets, current and long-term liabilities (for debt secured to pay costs) or net worth (for subsidies or contribu-tions)
	Cash flow	First month's operating expenses and term payments for future months

Budget

The social enterprise starts out as a program. Therefore, prior to addressing financial statements—balance sheets, profit and loss statements, and cash flow statements—we begin this section with a budget, the financial management planning instrument most development practitioners are already familiar with. A budget projects all expenses of the social enterprise as well as any additional expenses of the PO that are charged to the social enterprise program, usually on an annual basis. Normally, quarterly assessments are made of actual expenditures relative to those that have been planned.

Much of the budget is drawn from financial information completed in previous business plan chapters, such as marketing, operations, and human resources budgets (exhibits 8L and 8M). What has not been discussed in detail—other than PO salaries in the human resource chapter—is the parent organization's budget for staff, capacity building, and overhead as well as social enterprise operating overhead.

Exhibit 8M: Budget Information Flows



Budgeting Start-up Costs

New social enterprises will need to prepare a budget for first-month start-up costs to determine total capital requirements needed for fixed assets and working capital. Start-up costs, or ***sunk costs***, are the nonrecoverable costs of launching a business. Unlike many businesses, social enterprises have the luxury of having these paid by donors and are not required to recover this original investment. Considered pre-operating expenses, start-up costs are included in the financial needs section or budget of your social enterprise program proposal, as well as in the financial statements in your business plan.

***Sunk Costs*—**a cost that has been incurred and cannot be affected by present or future business decisions.

- ▲ Begin by looking over budgets completed in earlier sections of the business plan (operations, marketing, and human resources). Which expenses will you have to pay out prior to opening your doors? Which expenses will you have to pay in the first 30 days of operations?
- ▲ Partial payments for assets, or those made on credit, are deferred payments and will need to be included in your cash flow projections (discussed later in this chapter).
- ▲ Don't forget to include cash on hand for accrued salaries and working capital for the first month of operations.
- ▲ Use the Projected Start-up Costs template found in *The Workbook* or create your own. An example for TARTINA is given in exhibit 8N. Use it as a guide to projecting start-up costs for your social enterprise. Add additional line items or omit them as they pertain to your business.

Start-up cost projections are included in the Business Plan appendix.

Production team meets with Save the Children's advisor from headquarters.

Exhibit 8N: Projected Enterprise Start-up Costs

		Amount
Facilities	First rent/purchase	328
	Deposits (security, water, utility, other hookups)	600
	Improvements/refurbishing/fixtures	16,000
	Other	875
Equipment	Vehicles	30,000
	Production machines/equipment	12,000
	Computers/software	7,500
	Furniture	550
	Telephones	70
	Other	1,000
Materials/Supplies	Starting inventory (or raw materials/work in progress)	1,200
	Production inputs	800
	Office and packing supplies	450
	Promotional materials (brochures, displays, etc.)	1,250
	Training supplies	400
	Other	-0-
Professional Services	Legal (tax, etc.)	800
and Fees	Management/marketing/production consultants	1,200
	Accounting	-0-
	Insurance	780
	Design/graphic arts	250
	Promotion and advertising	1,200
	Licenses/permits/registration	650
	Membership or association fees	200
Pre-operations	Technical assistance or training consultants	2,400
Training	Tuition or fees (workshops, seminars, classes, etc.)	-0-
	Per diem and costs associated with training (room rental)	-0-
	Other	-0-
Cash	For salaries (first month)	4,900
(First 30 Days)	Reserves—operating expenses	2,500
	Reserves—unanticipated costs	2,000
	Other	-0-
Total Start-up Costs		**89,903**

TARTINA needed $89,903 to open its doors and run its operations for the first 30 days. The largest expenses were for vehicles, equipment and improvements to the production facility which included building a storage silo. Fair amounts were also spent on marketing and promotions as well as for technical and mangagement consultations.

Social Enterprise Program Budget

The budget for your social enterprise itemizes all the expenses projected for your program. In other financial statements you may want to consolidate financial information into broad categories, but your budget should be detailed. Exhibit 8P provides an example of a one-year budget for TARTINA Enterprise.

Exhibit 8P: TARTINA Budget: April 1999—April 2000

	% of Staff Time	$ Amount*	Q1	Q2	Q3	Q4
I - PERSONNEL						
Salaries						
Field/HR Manager (ADE Staff)	25%	3,939				
Production Manager	100%	10,909				
Business Manager	50%	7,758				
Marketing Manager	100%	13,758				
Financial Manager (ADE Staff)	30%	2,955				
Accountant	100%	6,909				
Inventory Manager	50%	1,891				
Production Workers	100%	10,879				
Production Agents	100%	5,727				
Secretary (ADE Staff)	40%	1,576				
Driver	100%	1,970				
Guard & Stock Keeper	100%	1,182				
Guard	100%	1,733				
Subtotal		**$71,185**				
13th Month		5,932				
Subtotal Salaries		**$77,117**				
Fringe Benefits						
Retirement Plan (ONA) 6% Salaries		4,330				
Medical Insurance (4%)		2,887				
Subtotal Fringe Benefits		**$7,217**				
TOTAL PERSONNEL		**$84,334**				
II - OPERATING COSTS						
Rent		3,939				
Assets:						
Motorcycle & Accessories		6,000				
Production Equipment		4,000				
Grinder (for sweetened peanut butter)		970				
Peanut Storage Instruments:						
Humidity Meter		400				
Thermometer		200				
Fan		1,000				

*Values given in US dollars

	$ Amount*	Q1	Q2	Q3	Q4
Insecticide	551				
Grinder Maintenance	121				
Building Maintenance	1,970				
Vehicle Depreciation	5,000				
Vehicle Maintenance	394				
Fuel	1,182				
Travel	788				
Office Supplies	788				
Training Materials	1,182				
Total Overhead	***$29,984***				
Technical Assistance:					
Consultants in Production Technique	5,666				
Materials (for study on improving raw materials production & quality)	1,500				
Research & Development	1,300				
Miscellaneous Expenses	1,450				
Total Technical Assistance	***$8,616***				
TOTAL OPERATING COSTS	**$38,400**				
III - MARKETING COSTS					
Promotion and advertising	***$10,145***				
Sale Agents: Base Salary					
3 agents x 1 month x Gdes 3000	545				
3 agents x 2 months x Gdes 3000 x 1/2	545				
3 agents x 10 mos. x Gdes 3000 x 1/2	1,363				
PAP/Institutional Sales Agent	2,364				
PG/Sales Agent	1,182				
Subtotal Base Salary	***$5,999***				
Commission					
Mamba (18300 Jrs x Gdes 25) x 15%	4,159				
Chadèque (12600 Jrs x Gdes 26) x 15%	2,978				
Grenadia (1200 Jrs x Gdes 30) x 15%	327				
Karapinia (8500 scs x Gdes 5) x 15%	386				
Subtotal Commission	***$7,851***				
Total Sale Agents	***$13,850***				
TOTAL MARKETING COSTS	**$23,995**				
SUBTOTAL	**$146,729**				
Less: Revenues	(14,922)				
TOTAL OPERATING COSTS	**$131,807**				

Preparing the Social Enterprise Budget

▲ Draw from institutional experience by having a qualified accounting staff professional prepare program budgets.

▲ Prepare a projected (pro forma) budget for one year, and include empty columns to reconcile actual expenses quarterly.

▲ Feed in budget information completed in earlier sections of the business plan (operations, marketing, and human resources) to develop your overall program budgets.

The social enterprise budget is included in the Business Plan appendix.

PARENT ORGANIZATIONS PROGRAM BUDGET

Most development practitioners have ample experience developing budgets for their programs. Use the human resources information in chapter 7 to help you prepare a program budget for the parent organization that will be providing technical support and acting as a financial conduit. Exhibit 8Q provides an example of Save the Children's budget to support capacity building of TARTINA Enterprise; the actual figures have been excluded for the sake of privacy.

EXHIBIT 8Q: SAVE THE CHILDREN SOCIAL ENTERPRISE PROGRAM BUDGET APRIL 1999—APRIL 2000

I - Salaries	% of Staff Time	Amount	Q1	Q2	Q3	Q4	Y-T-D
Headquarters: (U.S.)							
Technical Advisor*	10%	5,000					
Field Based: (Haiti)							
Country Director	10%	4,935					
Business Advisor	100%	43,776					
Program Manager	25%	12,660					
Director of Finance	15%	9,684					
Driver	25%	5,914					
Total Fringe		43,514					
Total Salaries Fringe		**125,483**					
Travel:							
Domestic		3,939					
International		3,723					
Total Travel Costs		**7,662**					
Overhead:							
Rent (based on space allocation)		3,100					
Utilities		197					
Building maintenance		394					
Computer + office equipment		2,313					

*No fringe benefit cost covered for HQ.

	Amount	Q1	Q2	Q3	Q4	Y-T-D
Equipment maintenance	2,200					
Office supplies	3,939					
Assets less than $5,000	3,000					
Vehicle (fuel/maintenance)	4,727					
Telecommunications	2,364					
Postage	45					
Miscellaneous	1,970					
Total Overhead	24,249					
Technical Assistance:						
Training materials	800					
Installation of MIS	5,400					
Marketing training	3,400					
Quality control	2,700					
Business management	2,500					
Food/production technology	4,400					
Market research	4,400					
Consultants	10,966					
Evaluation/Audit	5,000					
Total Technical Assitance	39,566					
TOTAL SC EXPENSES	**196,960**					

Preparing the Lead Organization (PVO) Budget

- ▲ Follow the instructions for preparing a social enterprise budget (previous section).
- ▲ Use the TARTINA example in exhibit 8M for reference. A blank form can be found in *The Workbook*.
- ▲ Lead organization budgets are not included in the social enterprise business plan.

PO budget is included in the Business Plan appendix.

Profit/Loss Statement

The profit and loss statement is a summary of the revenue and expenses of a company for a period of time. Sometimes called the income statement, the term profit and loss is preferable because it embodies the business reality that enterprises can lose as well as make money. The last line in the profit and loss statement indicates the net profit or loss of the enterprise, hence the reference to the "the bottom line." The profit and loss statement is used for purposes of planning, evaluation, and control. It is usually prepared for one-year increments and included in annual reports, etc. Profit and loss statements, however, should be produced monthly for internal management purposes.

Profit and loss statements are broken into a few sections:

Income

That which comes from sales of a product or service, as well as nonsales sources.

Costs of Goods Sold

Is made of all the costs allocated to inventory sold during a certain period.* The equation for calculating costs of goods sold is as follows:

Beginning Inventory
Add: Purchases or production costs
Equals: Costs of goods available for sale
Less: Ending inventory
Equals: Costs of goods sold

Deducting the costs of goods sold from income gives you gross profit, which represents the contribution that revenues make toward coverage of expenses not tied to production and toward net profit/(loss).

*Cost of goods sold is applicable only to production companies; services industries simply itemize their income, then deduct expenses in their income statements.

Operating Expenses

Also referred to as *general and administrative and selling expenses*, these are the expenses necessary to keep daily business operations running even if no goods are produced or services rendered. The general and administrative expenses include management and administrative salaries, communications, utilities, vehicles, equipment—such as computers used for administrative support—and other costs *not associated* with production. Selling expenses include marketing and promotional costs such as paid advertising and sales commissions.

General and administrative expenses—the expenses of running a business that are not directly allocated to the cost of making a product or rendering a service.

EXHIBIT 8R: PROFIT AND LOSS STATEMENT EXPLAINED

INCOME	
1. Gross sales	Total sales from product/service line categories.
2. Returns and allowances	Products returned; credit or discounts given to customers.
3. (1 - 2) Net sales	Total sales minus returns and allowances.
4. Other income	Revenues not associated with product or service "sales" such as rental, commissions, interest income, services that are not included in sales.
5. **(3 + 4) Income**	Total income from sales and non-sales activities.
Costs of Goods Sold	
6. Beginning inventory	Finished goods inventory on hand at the beginning of the period.
7. Plus: Purchases or production costs	Merchandise purchased for resale or costs incurred during production: inputs, raw materials, direct labor, depreciation on equipment used in produc tion, factory overhead (see operations budget in chapter 6).
8. (6 + 7) Costs of goods available for sale	Total costs of all goods for sale.
9. Ending inventory	Actual value of inventory left on hand at end of period.
10. **(8 - 9) Costs of Goods Sold**	Costs of inventory sold during an accounting period that includes the expenses incurred to make a product.

GROSS PROFIT	
12. (5 - 10) Gross profit	The value that an enterprise is earning over the cost of the merchandise sold (costs of goods sold). Operating expenses still need to be deducted from gross profit to arrive at net profit.
OPERATING EXPENSES	
12. Salaries	Salaries of management and administrative staff not directly connected to production.
13. Employee benefits	Paid vacation and leave, health insurance, 13th month, etc.
14. Payroll taxes	Self-explanatory (laws are country specific).
15. Rent	Non-factory real-estate expenses—rent or mortgage payments.
16. Repairs & maintenance	Cleaning services, repairs to property.
17. Equipment rental	Leased equipment for nonproduction usage.
18. Furniture and equipment purchase	Self-explanatory.
19. Vehicle(s)	Purchase (moped, truck, car, etc.), mileage.
20. Vehicle maintenance & repairs	Service and repairs.
21. Depreciation	Value of fixed assets (depreciation).
22. Insurance	Liability, vehicle, theft, fire, equipment, etc.
23. Interest expense	Interest owed on borrowed capital.
24. Utilities	Water, heat, power, light not used in production.
25. Telephone	Self-explanatory.
26. Office supplies	Usual business supplies (pens, staplers, paper, white boards, etc.) as opposed to production inputs.
27. Dues, subscriptions, licenses	Membership dues for affiliations or trade associations; fees for operating/product licenses, trademarks, or patents.
28. Training materials + services	Supplies and materials; contracted technical assistance.
29. Postage and freight	Self-explanatory.
30. Marketing and promotion	Advertising, design, premiums, samples, displays,etc.
31. Sales commission	Self-explanatory plus bonuses.
32. Legal and professional services	Any nontraining outside services (attorneys, consultants, auditors, accountants, technical specialists, etc.).
33. Travel	Self-explanatory.
34. Miscellaneous	Self-explanatory.
35. Other	Additional category pertinent to enterprise, but not captured in itemized list.
36. (sum of 12 through 35) Operating Expenses before Taxes	All operating expenses.

37. (11 minus 36)	Net profit/loss before tax
38. Provision for taxes	Tax on profits. Country-specific requirements often related to legal status of enterprise (see chapter 9).
39. (37 minus 38) NET PROFIT/LOSS (from operations)	The "bottom line"—how much the social enterprise is either earning or losing from operations.
40. SUBSIDY	Income from government and foundation grants or private funds.
(39 plus 40) TOTAL NET PROFIT/LOSS (after subsidy)	

PO business advisor, business manager, qualified staff accountants and the financial manager or director

Preparing the Profit and Loss Statement

▲ If yours is an existing social enterprise you may have already prepared profit and loss statements from past years of operation. **If not**, use this exercise to help you **prepare both** historic (previous year) and pro forma profit and loss statements.

▲ Use the explanation of the profit and loss statement in exhibit 8R for reference and use additional financial and accounting resources as desired.

▲ Prepare a projected (pro forma) profit and loss statement for each year covered in your business plan, and include empty columns to reconcile profit and loss, income and expenses. Copy our example or use the Profit and Loss Statement Worksheet, which can be found in *The Workbook*.

▲ Be sure to list the assumptions behind your profit and loss projections.

<u>The proforma profit and loss statements are included in the Business Plan appendix.</u>

Exhibit 8S: Pro Forma Profit and Loss Statement

TARTINA ENTERPRISE Profit and Loss Statement	Projections (in $)	ACTUALS				
	Year 1	Q1	Q2	Q3	Q4	Y-T-D
INCOME						
Gross Sales	58,271					
Less Cost of Goods Sold	43,349					
Gross Profit	**$14,922**					
OPERATING EXPENSES						
Salaries	77,117					
Fringe Benefits (+ Taxes)	7,217					
Total Personnel	**$84,334**					
Rent	3,939					
Assets $5,000 or Less	17,570					
Building Maintenance	1,970					
Vehicle Maintenance	394					
Fuel	1,182					
Travel	788					
Office Supplies	788					
Training Materials	1,182					
Consultants in Production Technique	5,666					
Marketing Consultants /Sales Agent	13,850					
Miscellaneous Expenses	1,450					
Equipment Maintenance	120					
Insecticide	551					
Materials for Raw Materials Production & Quality Improvement Study	1,500					
Research & Development	1,300					
Promotion & Advertising	10,145					
Operating Expenses before Taxes	**$146,729**					
Net Profit/Loss (before tax)[1]	**($131,807)**					
Subsidy	**$131,807**					
Net Profit/Loss (after subsidy)	**0**					

Results: *Comparing the projected profit and loss figures with TARTINA's financial objectives for profit/loss (exhibit 8B), it is easy to see their relationship. The financial objectives projected total expenses of $150,000 and net loss of $135,000, whereas the profit and loss statement projected expenses are very close at $146,729 with losses of $131,807. Similarly, projected profit and loss revenues of $14,922 are just shy of financial objectives set at $15,000.*

Note that the figure for total operating expenses of $146,729 is also the same as total fixed costs used in the break-even analysis in chapter 5.

TARTINA, under its current legal structure as an NGO business, is not required to pay taxes at this point. It receives a subsidy to offset its net loss of $131,807.

[1]TARTINA is a registered nonprofit organization and therefore does not pay tax.

Adjusting the Profit and Loss Statement to Include Social Costs[11]

Rationale

Once you have determined which social costs are significant to your enterprise and developed a methodology to calculate them, both bottom lines should be quantified in the profit and loss statement to capture the productivity of the business and the social costs of working with a particular disadvantaged target population. The first, "net income before social costs" reflects true business costs and provides a picture of how the social enterprise performs as a business. The second, "net income after social costs" indicates the program costs of providing assistance to the target population and how well the enterprise is meeting its social mission.[12] (exhibit 8T Double Bottom Line Profit and Loss Statement.)

The objective of this exercise is to delineate existing social costs that the business is currently subsidizing in its operating expenses using figures derived from methodologies developed in the exercise Quantifying Social Costs. Conducting a social cost assessment should not be viewed by managers as a way to carry inefficiencies in the business operations not stemming from the social mission, or "bury" costs since the total costs are still part of the overall performance of the enterprise.[13] Double bottom line profit and loss statements are essential tools for internal management decision-making that may or may not be required by donors and investors.

Business manager, accountants and finance staff, PO business advisor

- ▲ Return to the social costs figures you calculated in the exercise **Quantifying Social Costs**.
- ▲ Sum the total amount of social costs in dollar values or local currency. International donors of development programs usually ask for financial statements in dollar terms.
- ▲ Be careful not to double count. Subtract each social cost from the expense line item as it appears in the profit and loss statement. For example, if 30% of the enterprise manager's overall salary and benefits is dedicated to "extra" nonbusiness activities arising from the disadvantaged labor, be sure to deduct this amount from the line item total for the manager's salary and benefits in the operations expenses portion of the profit and loss statement.
- ▲ Sum total operating costs less total social costs in line item "net profit/loss before social costs." This is your first bottom line, denoting business performance.
- ▲ Then record total social costs in following line item "less social costs"
- ▲ Subtract total social costs to derive "net profit/loss after social costs." This is your second bottom line, denoting overall social enterprise performance including costs incurred to the carry out social mission.
- ▲ An example for TARTINA is included in exhibit 8T.

---

[11]Ibid. This concept was originally introduced in *New Social Entrepreneurs: The Success, Challenge and Lessons of Nonprofit Enterprise Creation* in its chapter on "True Cost Accounting," Jed Emerson and Fay Twersky, 1996, Roberts Foundation, SF, CA.
[12]*Investor Perspectives*, "Quantifying Social Costs: A Case Example from Rubicon's Buildings and Grounds Business," Kim Starkey, 2000, Roberts Foundation, SF, CA.
[13]Ibid.

EXHIBIT 8T: DOUBLE BOTTOM LINE PROFIT AND LOSS STATEMENT

TARTINA DOUBLE BOTTOM LINE **Profit and Loss Statement**	5/99-4/00	
Total Operating Expenses	**$146,729**	
Total Gross Revenue	**$14,922**	
NET PROFIT/LOSS BEFORE SOCIAL COSTS	**($82,395)**	**= Financial Bottom Line**
Less Social Costs	**($49,412)**	**= Social Bottom Line**
NET PROFIT/LOSS AFTER SOCIAL COSTS	**($131,807)**	**= Double Bottom Line**

TARTINA managers concluded that it costs an additional $49,412 in extra supervision, capacity-building, piece rate premium and loss in productivity due to inefficiency and illness to run TARTINA as a social enterprise rather than a for-profit business in year 1. TARTINA's operating deficit of $82,395 is considered normal for a similar production business in its first year.

Balance Sheet

The balance sheet is a snapshot of a social enterprise's financial position—what it owns (assets) and what it owes (liabilities and net worth)—at a given point in time. The liabilities and net worth on the balance sheet represent the business' sources of funds, whereas assets represent its use of funds. Liabilities and net worth derive from creditors and donors (or investors) who have provided cash or its equivalent to the enterprise or from earnings generated by the enterprise. As a source of funds, they enable the enterprise to continue in business or expand operations. Assets include all holdings of value that are owned or due to the business. Assets are either purchased with assets on hand, such as cash, or financed by liabilities (debt) or net worth (contributions or profit). Therefore, values represented in these categories reveal how efficiently an enterprise manages resources and finances its operations and, finally, the extent to which it is viable.

As the name implies, a balance sheet must balance. The relationship between the three sections of a balance sheet are shown in the following equations:

Assets = liabilities + net worth

Assets – liabilities = net worth

Rationale:
Sound financial management of an enterprise involves matching the sources and uses of cash so that obligations come due as assets mature into cash. The balance sheet is a financial tool that monitors the enterprise's ability to collect revenues and manage inventory as well as assesses its ability to satisfy creditors, donors, and investors. Although individual line items and category values change on a daily basis, reflecting financial transactions and business activities, the balance captures the financial picture at one moment in time, usually at the end of an accounting period (exhibit 8V). Analyzing the changes in the balance sheet over several reporting periods informs enterprise trends.

EXHIBIT 8U: BALANCE SHEET EXPLANATION

ASSETS	Assets are shown at net ***book value*** rather than appreciated value.
Current Assets	Assets that mature in less than one year.
Cash	Cash on hand: checking, money-market and short-term savings accounts.
Accounts receivable	Money owed from customers who receive goods or services in advance of payment. Inventory is sold and shipped, an invoice is sent to the customer, and later cash is collected.
Inventory Prepaid expenses	Finished goods for sale, work in progress, raw materials on hand Goods, benefits, or services an enterprise buys or rents in advance of use—i.e., office supplies and insurance premiums.
Other current assets	Interest- or dividend-yielding holdings expected to be converted into cash within a year—i.e., marketable securities, time deposits, etc.
Total Current Assets	Self-explanatory.
Noncurrent Assets	Assets that will not mature into cash within the next 12 months.
Fixed Assets	Resources an enterprise owns or acquires for use in operations; not intended for resale. Fixed assets represent the use of cash to purchase physical assets whose life exceeds one year.
Land	Listed at original purchase price with no allowance for appreciation or depreciation.
Building	Property owned and used by the enterprise.
Machinery & equipment	Used by the enterprise; listed at original purchase price.
Furniture & fixtures	Furniture used by the enterprise or permanent installations, remodel ing, or refurbishing of the premises.
Vehicles	Used by the business and listed at their original purchase price.
Less accumulated depreciation	Total assets (except land) lose their value through age and wear and tear. The enterprise claims this loss of value as an expense of doing business and deducts it from total assets. Accumulated depreciation is the cumulative sum of all the years' worth of wearing out that have occurred in the asset.
Net Fixed Assets	Gross fixed assets (purchase price) – accumulated depreciation (not including land) = net fixed assets (also known as book value).
Other assets	Enterprise resources not listed in above asset categories—i.e., scrap value of obsolete equipment or intangible assets such as trademarks, patents, ***goodwill***.
TOTAL ASSETS	Net fixed assets + other assets (scrap value) – ***amortization*** (for intangible assets) = TOTAL ASSETS.
LIABILITIES	All monetary obligations of an enterprise and all claims creditors have on its assets.
Current Liabilities	All debts and obligations payable within one year.
Accounts payable	Amount owed to suppliers.
Short-term notes	Balance of principal on loans with terms of one year or less.
Interest payable	Balance of interest due at period end but not yet paid on long-term and short-term borrowing.
Accrued payroll	Salaries and wages currently owed.
Taxes payable	Amounts owed for real estate, Social Security, and income tax.
Total Current Liabilities	Self-explanatory.
Long-Term Liabilities	Debts such as mortgage and loan principal due in more than one year.

Book value—the value of an asset whose historical cost has been adjusted for **depreciation** or **amortization**. Book value is also referred to as **net fixed asset value** and is reflected in the **balance sheet** of an enterprise.

Goodwill—Excess value of asset over market value (or book value). Goodwill appears in financial statements when a business is valued above it assets shown on its books.

Amortization—costs of an intangible asset are allocated over its useful life.

Mortgage payable	Balance owed on property.
Long-term notes	Outstanding balance on loans payable in more than one year.
Total Long-Term Liabilities	
TOTAL LIABILITIES	Total current liabilities + total long-term liabilities.
NET WORTH	Also called owners' equity, net worth is equal to assets less liabilities. It represents the value of the enterprise. Net worth includes subsidies, investors' or owners' contributions, retained earnings, and revenue surpluses.[14]
Donor contributions	Donor grants or private PO nonprofit partner funds used to subsidize operations.
Owner contributions	PO partner or individual resources allocated as an ownership stake.
Reserves for bad debt	Provision against loss for uncollectible loans.
Shareholder equity	Value of investor stakes for social enterprises that have formalized into business entities.
Retained earnings (Losses) prior years	Amount of income (or loss) accumulated since the beginning of the enterprise[15] and reinvested (for profit).
Net surplus/(deficit)	Amount of income (or loss) generated in the current year.[16]
TOTAL NET WORTH	Total value of the enterprise.

PO business advisor, business manager, qualified staff accountants and a financial manager or director

Preparing a Social Enterprise Balance Sheet

▲ If yours is an existing social enterprise you may have already prepared balance sheets from past years of operation. **If not**, use this exercise to help you **prepare both** historic (previous year) and pro forma balance sheets.

▲ Use the balance sheet explanations in exhibit 8U for reference and additional financial and accounting resources as required.

▲ Prepare a projected (pro forma) balance sheet for each year covered by the business plan, and include empty columns to reconcile actual balance sheet assets, liabilities, and net worth. Copy our example or use a the **Balance Sheet Worksheet**, which can be found in *The Workbook*.

▲ Be sure to list the assumptions behind your balance sheet projections.

The historic and pro forma balance sheets are included in the Business Plan appendix.

[14] Adapted from SEEP Network Financial Servicew Working Group, 1995. *Financial Ratio Analysis of Microfinancial Institutions.* New York: Pact Publications.
[15] Ibid.
[16] Ibid.

EXHIBIT 8V: PRO FORMA BALANCE SHEET

TARTINA ENTERPRISE Projected Balance Sheet	Projections Year 1	Q1	Q2	Q3	Q4	Y-T-D
ASSETS						
Current Assets						
Cash on Hand	17,482					
Savings Account						
Accounts Receivable	15,742					
Inventory						
Raw Materials	1,950					
Finished Products	9,276					
Total Current Assets	44,450					
Fixed Assets						
Property, Plant, Equipment	33,524					
Office Equipment	3,351					
Land and Buildings	15,500					
Vehicles	34,000					
Less Accumulated Depreciation	(526)					
Total Fixed Assets	85,849					
TOTAL ASSETS	**$130,299**					
LIABILITIES						
Current Liabilities						
Accounts Payable	15,114					
Accrued Payroll	6,487					
Short-Term Notes Payable	11,738					
Noncurrent Liabilities	0					
Long-Term Notes Payable	0					
TOTAL LIABILITIES	33,339					
NET WORTH						
Reserves for Bad Debts	25,000					
Donor Contributions	203,767					
Retained Earnings (Losses)	0					
Net Surplus/Loss	(131,807)					
TOTAL NET WORTH	96,960					
TOTAL LIABILITIES & NET WORTH	**$130,299**					

Explanation: *TARTINA's projections assume a net loss of $131,807 in its first year of operations. Donor subsidies of $203,000 from ASSIST will be used to cover start-up costs for fixed assets as well as bridge TARTINA's operating deficit. TARTINA's current value is $90,299, roughly two-thirds of which is represented by fixed assets and the other one-third by current assets, cash, and inventory. In this example it is easy to see*

Cash Flow

Cash is money in the bank, plain and simple. It is not merchandise, inventory, money owed to you from credit sales (accounts receivable), and it is certainly not property or equipment. Although these assets may eventually be converted into cash, they don't take the place of cash—meaning that you can't pay your rent with a sewing machine or moped. Invariably social entrepreneurs and business people alike must have cash to pay their suppliers, utilities, payroll, etc. Balancing expenses against revenues is challenging and requires careful management as cash enters and leaves the business.

Too often, financially viable businesses fail because of cash flow problems. Managers are unable to manage receipts and payments of cash within a business, causing critical cash shortages. In most enterprises, the inflow of cash revenue from product or service sales lags behind the outflow of expenses needed to produce those goods or run the business. A **cash flow statement** is a financial statement that reconciles accrual revenue and expenses in the profit and loss statement to net cash collected or paid. It tells social enterprise managers where the money went and where it came from and gives a picture of the cash position—or amount of money in the bank. Of course cash on hand does not equal profit if expenses are outstanding but not yet paid. Accrual accounting was developed because profit is considered a better measure of business performance than net cash received; nonetheless, projecting and recording cash flows is an essential part of good business operations.

A **cash flow projection** is a financial tool used for forecasting potential cash shortages so that the social enterprise can make plans to address these shortages. Likewise, it also indicates the happy case of excess cash, when the enterprise may choose to invest this cash instead of leaving it idle. For a new or growing business, the cash flow projection can mean the difference between success and failure. For an ongoing business, it can mean the difference between growth and stagnation. Social enterprise managers need to be diligent about projecting cash flow regularly—at least monthly.

The cash flow projection enables you to predict and plan cash outlays in order to:

- ▲ Ensure that you have enough cash to purchase sufficient inventory or raw materials to weather seasonal cycles;
- ▲ Plan your purchases of new equipment or building;
- ▲ Benefit from special offers and discounts that require advance or bulk purchase;
- ▲ Arrange for financing and identify the type of financing and duration—i.e. bank credit line to relieve short-term overruns and shortages; working capital to absorb ebbs and flows of the business cycle, or capital asset or debt financing for major purchase of equipment, land or facilities); and
- ▲ Establish a history of credit worthiness for future lenders and investors.

Savvy social enterprise managers develop both short-term cash flow projections to help them manage daily cash and long-term cash flow projections to help them develop the necessary financing strategies to meet their business needs.

EXHIBIT 8W: USES FOR CASH FLOW PROJECTIONS

Time Period	Use
Short term (monthly)	Determine immediate and short-term cash balance. Estimate working capital requirements to finance daily operations. Plan current asset investments such as savings deposits, money market accounts and CDs.
Annual	Determine cash needs for business operations during the year. Identify sources of cash, including revenue and financing. Ascertain determine seasonal fluctuations and related impact on cash flow. Estimate annual financing needs and the ability to make repayments on borrowed money.
Three to five years	Augment strategic and business planning. Determine long-term equity needs, including raising equity capital. Estimate long-term borrowing requirements for capital investments relating to growth and capital asset purchase.

Preparing the Cash Flow Projections

Rationale

Liquidity can be a killer for a social enterprise—or any business. A lack of profits will not put you out of business as fast as a lack of cash to pay your creditors. The irony is that profits can be negative when cash flow is positive and vice versa. Cash, however, is what you must have to keep your social enterprise running while you are trying to make a profit. This requires careful cash management. At times when no money is in the till, the business needs an extra boost of cash. Or when your enterprise is flush, idle cash should be invested to make more money. Projecting cash flow, somewhere between balancing a checkbook and preparing a budget, is an excellent way to forecast cash shortages and surpluses and plan for them.

TARTINA found that commercial customers expected to either purchase products on credit or sell them on commission. Both instances demanded that TARTINA finance costs for as much as a few months before receiving payment from its supermarket customers. TARTINA management used cash flow projections to estimate when these credit sales would be converted into cash. In addition, the availability of peanuts and fruits for TARTINA products is seasonal. TARTINA buys its raw materials in bulk during growing seasons in January, March and December then stores them in silos for processing throughout the year. These bulk purchases require large outlays of cash up front, tying up this money until goods are finished and sold. Preparing a cash flow projection helped TARTINA determine its cash needs to purchase raw materials and secure sources of credit to finance them.

The template for a cash flow projection looks similar to a profit and loss statement, yet certain changes can be captured in a cash flow that are not reflected well in a profit and loss statement, such as:

- Large inventory purchases;
- An increase in accounts receivable;
- A decrease in credit by suppliers;
- Liquidation of obsolete inventory;
- Grant closure or loan recall;
- Receipt of large payment of debt.

Exhibit: 8X: Cash Flow Projection Explained

Cash Flows In	MONTHLY RECEIPTS FROM:
1. Beginning Cash Balance	**Cash on hand at the beginning of the month**
Cash receipts:	
2. Cash from sales	All cash from sales **only**; omit credit sales receipts
3. Accounts receivable & collected	Cash collected for credit sales
4. Subsidy and loans	injections from grants, PO subsidies, lenders, etc.
5. Investment and interest	Cash earned on investment
6. (2+3+4+5) Total Cash In	**Total amount of cash received in month**
7. (1+6) Total Cash Available	**Total cash on hand**
Cash Flows Out	**MONTHLY PAYMENTS FOR:**
8. Purchases	Raw materials, production inputs, or merchandise for resale
9. Salaries	Permanent management and staff
10. Wages	Base pay plus overtime and bonuses for labor
11. Payroll expenses	Vacation and leave, health insurance, 13th month, employment taxes, etc.
12. Sales commission	Commissions and bonuses awarded to sales staff
13. Sales tax	Tax paid on sales, exercise tax, etc.
14. Rent	Real estate rent only (factory, storage, and administration)
15. Repairs & maintenance	Property and facilities (factory and administration)
16. Equipment rental	Equipment leasing (for production and administration)
17. Furniture and equipment purchase	Furniture leasing (for production and administration)
18. Vehicle(s)	Purchase of vehicle (moped, truck, car, etc.) + mileage
19. Vehicle maintenance & repairs	Service and repair vehicles.
20. Insurance	Liability, vehicle, theft, fire, equipment, etc. (coverage on factory and administration)

21. Interest expense	Interest payments on borrowed capital (loans)
22. Utilities	Water, heat, power, light used in production and administration
23. Telephone	Phone, fax, electronic communications
24. Office supplies	Business supplies (pens, staplers, paper, white boards, etc.) as opposed to production inputs
25. Dues, subscriptions, licenses	Membership dues for affiliations or trade associations; fees for operating/product licenses, trademarks, or patents
26. Training materials + services	Supplies and materials; contracted technical assistance
27. Postage and freight	Self-explanatory
28. Marketing and promotion	Advertising, design, premiums, samples, displays, trade fairs fees, brochures, etc.
29. Legal and professional services	Any nontraining outside services (attorneys, consultants, auditors, accountants, technical specialists, etc.)
30. Travel	Business travel
31. Miscellaneous	Additional category pertinent to enterprise, but not captured in itemized list
32. Other	
33. (Add 8 through 32) Cash Out	**Total Cash Out**
34. Loan principal	Amount of principal payments on all loans
35. Owners withdrawal	Payments made in lieu of salary to cover owner's expenses (generally only in sole proprietorships and partnerships) include insurance
36. (33 + 34 + 35) Cash Paid	**Total Cash Paid Out**
37. (7 - 36) ENDING CASH BALANCE	**Total cash at the end of the month**

PO business advisor, business manager, accounting and finance staff

Cash Flow Projections

The first part of the cash flow projection forecasts cash coming into the enterprise; the second part projects cash going out. When used for internal management purposes cash flows should be projected on a monthly basis; however, as a financial statement for donor-investors cash flows are generally consolidated and projected by quarter or over a year.

▲ Locate the blank table **Cash Flow Projections Worksheet** provided in *The Workbook*, or create your own template.

▲ Add line items where necessary to accurately reflect the cash flows in your business. The level of detail needed in your cash flow projection will vary depending on the complexity of your business. In our example TARTINA combines the rent, utility, equipment leasing, repairs and insurance expenses for both its production and administrative facilities in its cash flow projection.

- Always start with “Beginning Balance” (the first line item); this is your cash on hand at the start of the month.
- Fill in the worksheet using historic records (if you have been in business for a while), market research and price quotes to project **monthly** income and expenses.
- Use the cash flow projection explanation in exhibit 8X for reference and supplementary financial and accounting resources if necessary.
- Follow directions, adding and subtracting columns to derive **ending cash balance. Remember this figure is the beginning balance for the following month.**
- Prepare quarterly cash flow projections (four months or one worksheet) for one year.
- Be sure to list the assumptions behind your cash flow projections.
- Eventually you should set up your cash flow projections using a PC spreadsheet. After the initial setup, this will make the process much faster. You can enter formulas for the subtotals and totals to eliminate addition/subtraction errors.
- Similar to methods used for preparing other financial tools, this one can be applied first to *projecting* your cash flow, which is then reconciled against *actual* cash expenses in a cash flow statement at the end of the period.

The cash flow projections are included in the appendix section of your Business Plan.

Explanation of TARTINA example: *On the following page is a cash flow statement for a 12-month period for the TARTINA social enterprise. This particular cash flow statement highlights two other benefits of this financial tool. First, it highlights the variability of TARTINA’s cash needs due to the seasonality of the business. Second, because TARTINA planned its cash flow requirements in advance, it was able to determine when it could outlay cash for bulk purchases of key production materials, such as peanuts, fruits, containers and labels. This translated into cost savings for TARTINA.*

TARTINA display in supermarket

Production agent with four client-producers

TARTINA CASH FLOW STATEMENT

	APRIL 1999	MAY 1999	JUNE 1999	JULY 1999	AUGUST 1999	SEPT 1999	OCT 1999
REVENUE							
OPENING BALANCE		43,765	58,530	54,767	10,365	42,869	16,438
CASH SALES	27,200	35,600	22,325	26,875	28,000	38,475	38,800
ACCOUNTS RECEIVABLE	9,067	20,933	28,375	28,267	25,733	31,117	35,092
CASH NOT AVAILABLE UNTIL END OF MONTH	(36,267)	(20,267)	5,833	(4,442)	1,408	(15,858)	(4,300)
TOTAL REVENUE IN LOCAL CRRCY	**-**	**80,032**	**115,063**	**105,467**	**65,507**	**96,602**	**86,030**
TOTAL REVENUE IN U.S.$	**$ -**	**$ 4,850**	**$ 6,974**	**$ 6,392**	**$ 3,970**	**$ 5,855**	**$ 5,214**
SUBSIDY	$ 11,279	$ 18,709	$ 8,709	$ 8,709	$ 8,709	$ 8,709	$ 8,709
TOTAL FUNDS AVAILABLE BEGINNING OF MTH	**$ 11,279**	**$ 23,559**	**$ 15,683**	**$ 15,101**	**$ 12,679**	**$ 14,564**	**$ 13,923**
EXPENSES							
PRODUCTION COSTS							
Mamba (Peanut) : Peanuts	36,605			49,267			
Spices	660	660	587	587	587	697	697
Labor	5,280	5,280	4,692	4,692	4,692	5,572	5,572
Other	1,452	1,452	1,290	1,290	1,290	1,532	1,532
Confitures (Jam): Chadeque & Spices						1,380	1,380
Sugar						2,820	2,820
Labor						1,020	1,020
Other						840	840
Grenadia & Lemon				1,440	2,520	3,888	4,248
Sugar				1,880	3,290	5,076	5,546
Labor				520	910	1,404	1,534
Other				200	350	540	590
Apricot & Lemon		1,600	1,600	1,600			
Sugar		1,880	1,880	1,880			
Labor		360	360	360			
Other		200	200	200			
Gelee (Jelly) : Sour Fruit & Lemon		360	360	360			
Sugar		2,520	2,520	2,520			
Labor		200	200	200			
Other		600	600	600			
Karapinia : Peanuts	9,880			10,660			
Spices	280	280	200	200	220	200	200
Sugar	3,360	3,360	2,400	2,400	2,640	2,400	2,400
Labor	560	560	400	400	440	400	400
Other	840	840	600	600	660	600	600
Containers : Mamba (Peanut Butter)	33,000					27,390	
Confitures (Jam)	64,890					64,890	
Gelee (Jelly)	13,440						
Karapinia	2,400			2,400			2,400
Labels : Mamba (Peanut Butter)	10,000					8,300	
Confitures (Jam)	6,300					6,300	
Gelee (Jelly)	1,200						
Karapinia	800			800			800
TOTAL PRODUCTION COSTS IN LCL CRRCY	**190,947**	**20,152**	**17,889**	**85,056**	**17,599**	**135,249**	**32,579**
TOTAL PRODUCTION COSTS IN US$	**$ 11,573**	**$ 1,221**	**$ 1,084**	**$ 5,155**	**$ 1,067**	**$ 8,197**	**$ 1,974**
M.E. Profit (6.70% of Production Costs) ((3.165% of Sales)	**$ 775**	**$ 82**	**$ 73**	**$ 345**	**$ 71**	**$ 549**	**$ 132**
TOTAL PROD. COSTS & M.E. PROFIT IN US CRRCY	**$ 12,348**	**$ 1,303**	**$ 1,157**	**$ 5,500**	**$ 1,138**	**$ 8,746**	**$ 2,107**
APV OPERATIONAL COSTS IN U.S.$							
AID Funded Costs	$ 11,279	$ 18,709	$ 8,709	$ 8,709	$ 8,709	$ 8,709	$ 8,709
APV Fees (21.5818% of Production Costs) ((10.196% of Sales)			$ 2,498	$ 264	$ 234	$ 1,113	$ 230
TOTAL APV OPERATIONAL COSTS IN U.S.$	**11,279**	**18,709**	**11,207**	**8,973**	**8,943**	**9,822**	**8,939**
TOTAL EXPENSES	**$ 23,627**	**$ 20,012**	**$ 12,363**	**$ 14,473**	**$ 10,081**	**$ 18,567**	**$ 11,046**
END OF MONTH SURPLUS/DFICIT IN U.S.$	(12,348)	3,547	3,319	628	2,598	(4,004)	2,877
CREDIT	$ 15,000					$ 5,000	
END OF MONTH NET BALANCE IN U.S.$	**2,652**	**3,547**	**3,319**	**628**	**2,598**	**996**	**2,877**
END OF MONTH NET BALANCE IN LCL CRRCY	**43,765**	**58,530**	**54,767**	**10,365**	**42,869**	**16,438**	**47,471**

NOV 1999	DEC 1999	JAN 2000	FEB 2000	MARCH 2000	APRIL 2000	TOTAL	MAY 2000	JUNE 2000	GRAND TOTAL
47,471	22,787	24,408	13,496	54,504	98,179		24,020	156,669	
39,925	40,600	40,600	42,350	52,900	52,900	486,550			486,550
39,067	39,775	40,375	41,183	45,283	49,383	433,650	35,267	17,633	486,550
(5,100)	(1,383)	(600)	(2,558)	(14,650)	(4,100)	(94,917)	102,283		7,366
121,363	**101,779**	**104,783**	**94,471**	**138,038**	**196,363**	**825,283**	**161,570**	**174,302**	**980,466**
$ 7,355	**$ 6,168**	**$ 6,351**	**$ 5,725**	**$ 8,366**	**$ 11,901**	**$ 50,017**	**$ 9,792**	**$ 10,564**	**$ 59,422**
$ 8,709	$ 14,723	$ 8,709	$ 8,709	$ 13,715	$ 8,709	$ 136,807			$ 136,807
$ 16,064	**$ 20,891**	**$ 15,060**	**$ 14,434**	**$ 22,081**	**$ 20,610**	**$ 186,824**	**$ 9,792**	**$ 10,564**	**$ 196,229**
29,933	29,933	29,942				175,680			175,680
697	899	899	899	989	297	9,150			9,150
5,572	7,188	7,188	7,188	7,908	2,376	73,200			73,200
1,532	1,977	1,977	1,977	2,175	653	20,130			20,130
1,380	1,380	2,300	2,300	1,380		11,500			11,500
2,820	2,820	4,700	4,700	2,820		23,500			23,500
1,020	1,020	1,700	1,700	1,020		8,500			8,500
840	840	1,400	1,400	840		7,000			7,000
3,888	3,528	3,528				23,040			23,040
5,076	4,606	4,606				30,080			30,080
1,404	1,274	1,274				8,320			8,320
540	490	490				3,200			3,200
						4,800			4,800
						5,640			5,640
						1,080			1,080
						600			600
						1,080			1,080
						7,560			7,560
						600			600
						1,800			1,800
6,370	6,370	6,240				39,520			39,520
220	200	200	220	310	310	3,040			3,040
2,640	2,400	2,400	2,640	3,720	3,720	36,480			36,480
440	400	400	440	620	620	6,080			6,080
660	600	600	660	930	930	9,120			9,120
						60,390			60,390
						129,780			129,780
						13,440			13,440
		1,920				9,120			9,120
						18,300			18,300
						12,600			12,600
						1,200			1,200
		640				3,040			3,040
65,032	**65,924**	**72,404**	**24,123**	**22,711**	**8,906**	**758,570**	**-**	**-**	**758,570**
$ 3,941	**$ 3,995**	**$ 4,388**	**$ 1,462**	**$ 1,376**	**$ 540**	**$ 45,974**	**$ -**	**$ -**	**$ 45,974**
$ 264	**$ 268**	**$ 294**	**$ 98**	**$ 92**	**$ 36**	**$ 3,079**	**$ -**	**$ -**	**$ 3,079**
$ 4,205	**$ 4,263**	**$ 4,682**	**$ 1,560**	**$ 1,469**	**$ 576**	**$ 49,053**	**$ -**	**$ -**	**$ 49,053**
									-
									-
$ 8,709	$ 14,723	$ 8,709	$ 8,709	$ 13,715	$ 8,709	$ 136,807			$ 136,807
$ 1,769	$ 426	$ 851	$ 862	$ 947	$ 316	9,508	$ 297	$ 116	9,922
10,478	**15,149**	**9,560**	**9,571**	**14,662**	**9,025**	**146,315**	**297**	**116**	**146,729**
$ 14,683	**$ 19,412**	**$ 14,242**	**$ 11,131**	**$ 16,131**	**$ 9,600**	**$ 195,368**	**$ 297**	**$ 116**	**$ 195,782**
									-
1,381	1,479	818	3,303	5,950	11,009	(8,544)	9,495	10,447	447
					$ (10,000)	$ 10,000		$ (10,000)	$ -
1,381	**1,479**	**818**	**3,303**	**5,950**	**1,009**	**1,456**	**9,495**	**447**	**447**
22,787	**24,408**	**13,496**	**54,504**	**98,179**	**16,654**	**24,020**	**156,669**	**7,380**	**7,380**

Preparing the Cash Flow Statement

Rationale

Cash flow statements made a relatively late appearance in the world of required financial statements. The widespread recognition that cash flow problems often result in the premature death of a business is the reason why more and more lenders, donors and stakeholders are requiring social enterprises and business to remit cash flow statements along with balance sheets and profit and loss statements.

Cash flow statements classify cash receipts and payments into three categories: operating, investing and financing.

- **Operating cash flow—**is sometimes called working capital; it flows from cash internally generated from operations such as sales—and to expenses that sustain operations such as salaries, rent materials and supplies.
- **Investing cash flow—**flows from internally generated nonoperating activities, such as sales of long-term investments—and to investments such as purchase of property or equipment.
- **Financing cash flow—**flows from and to external sources, such as donors, lenders, investors, and shareholders in the form of a disbursement or payment of a grant or loan.

Marketable securities—short-term investments with well-defined dollar value such as bonds, treasury bills, or stocks that are easily convertible into cash.

Equity—monetary value that represents an ownership stake or net worth in an enterprise. Issuing stock or selling equity stakes raises capital for a business. For example if a PO takes equity in its social enterprise it purchased partial ownership of the enterprise. In publicly traded companies, issuance of stock signifies selling very small pieces of the company.

EXHIBIT 8Y: CLASSIFICATION OF CASH INFLOWS AND OUTFLOWS

CASH INFLOWS	ACTIVITY	CASH OUTFLOWS
From sales of products and services	**OPERATING**	To employee salaries and wages To suppliers for inventory
From interest or dividends on loans or investments		To creditors for interest
		To other operating expenses (rent, utilities, equipment, etc.)
From sale of plant, property, equipment or other capital asset	**INVESTING**	To purchase new plant, property, equipment or capital asset
From sale of long- or short-term ***marketable securities***		To purchase long or short term marketable securities
From collection of loans		To make loans
From grant or subsidy	**FINANCING**	To repay loans
From borrowed capital (loan)		To pay dividends
From the sale of stock/***equity***		To purchase stock

There are two methods for preparing a cash flow statement. The first, the direct method, involves making adjustments to convert income and expense items from accrual to cash basis. The indirect method starts with net income (or loss) before non-cash expenses, then makes adjustments for inflows and outflows of cash that were not included in the net income/loss calculation. This method is simpler because 90% of the cash flow calculation is completed in the net income calculation, which is in fact an estimate of your cash flow. This book teaches the indirect method for preparing a cash flow statement; if you are interested in learning the direct method ask your accountant, or check other accounting resources.

Exhibit 8Z is a conceptual example of a consolidated cash flow statement using the indirect method. It illustrates the three basic steps required to complete a cash flow statement: 1) Begin with net income; 2) add in non-cash expenses (this is because your net income can be reduced by expenses such as depreciation that were never disbursed); and 3) adjust for inflows and outflows of cash for investing and financing activities not recorded in the net income calculation (but reflected in the balance sheet).

Exhibit 8Z: Example of Indirect Cash Flow Method

Net Income before non-cash expenses		
Begin with	Net Income (loss)	$800,000
Add in	Depreciation	100,000
		$900,000
Adjustments to cash from operating activities		
Flows in (add)	Decrease in accounts payable	$200,000
Flows out (subtract)	Increase in accounts receivable	(300,000)
	Increase in inventory	(150,000)
	Increase operating expenses	(250,000)
Net Cash from Operating activities		$400,000
Adjustment to cash flow from investing activities		
Flows in (add)	Decrease in notes receivable	$100,000
Flows out (subtract)	Purchases: equipment, land, plant	(250,000)
Adjustment to cash flow from financing activities		
Flows in (add)	Grants and subsidy received	200,000
Flows out (subtract)	Repayment on loan (long-term debt)	(100,000)
Net Cash provided (used)		**$350,000**

Cash Flow Statement

- ▲ Locate the blank **Cash Flow Statement** in worksheet in The Workbook, or create your own.
- ▲ **!!! It is important to note that the cash flow statement begins with net income as if all expenses were paid in cash and all income was received in cash.** The formula then makes adjustments to reconcile net income to net cash flow from operating, investing and financing activities.

- ▲ Calculate net income before non-cash expenses.
- ▲ Add back non-cash expenses that did not result in inflows or outflows of cash. Depreciation is the most common non-cash expense.
- ▲ Identity operating cash flows. Refer to exhibit 8Y: Classification of Cash Inflows and Outflows for help identifying receipts and payments classified as operating activities.
- ▲ Subtract out flows and add inflows. Be careful not to confuse inflows with outflows; receipts (added) and payments (subtracted). Follow the example in exhibit 8Z: Example of Indirect Cash Flow Method.
- ▲ Repeat steps for investing cash flow and financing cash flow.

The cash flow statement is included in the appendix section of your Business Plan.

the balance sheet equation at work.

Risk/Sensitivity Analysis and Contingency Planning

It is essential to know the financially vulnerable points of your social enterprise (which are often in the categories where the largest expenditures occur). What happens to social enterprise profitability if raw material costs increase by 10 percent? If inflation goes up to 15 percent or 20 percent? What if the sales forecast is realized only at 80 percent? What happens to cash flow if a major piece of equipment conks out before its projected usable life?

Projecting financial statements and budgets requires troubleshooting different potential scenarios that can impact your bottom line. Playing out "what if" scenarios enables you to see that financial impact and allows for ***contingency planning***, so that you are ready with plan B if necessary. Most changes in the operating environment do not drop from the sky but can be predicted to some degree if enterprise managers continually appraise the strategic environment, and the enterprise's strengths and weaknesses (chapter 4). For example, TARTINA's peanut butter and jam production is mainly a variable-cost business highly susceptible to changes in the price of raw materials. Bad weather affects crop yields, causing peanut prices to go up. Seasonality is another factor; when peanuts or fruits are out of season, their prices increase. Therefore, TARTINA management makes its financial projections at different peanut costs, beginning as low as 10 gourdes per marmite and going up to as much as 16 gourdes, to see how price fluctuations impact the bottom line and think through decisions it will need to make based on different peanut price levels.

Sensitivity analysis—a tool used to project expense and income levels by manipulating cost and revenue variables in a company, such as changes to production level, costs of inputs (fixed or variable), or prices.

Contingency planning—Preparing alternative strategies and plans that correspond to a liable risk occurring, which threatens the plausibility of the chosen plan.

PO business advisor, business manager, financial manager, accountant, program manager, other relevant functional managers

Preparing a Sensitivity Analysis and Contingency Plans

- ▲ Use a PC spreadsheet or other software program that generates your financial statements. After the initial formulas are set up, computer programs make sensitivity analysis much faster and more reliable.
- ▲ Isolate the largest expenditures of your social enterprise, and use these as the variables in your sensitivity analysis to develop two or three "what if" scenarios by changing variable values, and then review the impact of these changes on financial statements.
- ▲ Now select key variables reflected in anticipated or likely changes to the operating environment based on your market research (i.e., inflation); plug these numbers into your sensitivity analysis and repeat the previous step.
- ▲ Analysis: What decisions will you make based on the sensitivity analysis results? How will these decisions affect business operations? For example, will you have to lay people off, enter a market more rapidly than expected, forsake a fixed-asset purchase for several months, invest in new-product development to remain competitive, take a short-term loan for operations to bridge income lags, etc.?
- ▲ Contingency plans explaining how management plans to respond to certain risk exposure in a given industry, market, or strategic environment strengthen a business plan by increasing the perception of the social enterprise management's credibility and capacity.

<u>Contingency plans are included in Business Plan.</u>

Resource Acquisition

Rationale:

Several elements shape the resource acquisition strategy: investor-donor landscape, reputation of the parent organization, management competence and development stage of the enterprise. Most donors and investors have specific criteria that must be met by applicants in order to receive their money (exhibit 8DD: Donor-Investor Criteria and Applications). Another important aspect is captured in the adage "people give money to people"; leveraging the brand equity of the parent organization or the expertise of your management team can attract investment funds. The maturity of the enterprise, the strength of its financial position, and its ability to generate revenue will also dictate the type of funds required and most suitable source for them (see box: Enterprise Development Stage).

Just as savvy financial investing involves balancing risk by diversifying the investment portfolio, in resource acquisition it is unwise to depend solely on a single donor or investor for all the financial needs of the enterprise. During startup it is difficult to find investors willing to assume risk for the novice. In this case, small, short-term (i.e. one year or less) funding is cobbled together from various sources including the parent organization and grants until the enterprise pilot can demonstrate some success. Once a track record is establish and the enterprise program enters growth stage, mezzanine level funds, which are easier to obtain, are sought. The startup funding is usually awarded as an investor vote of confidence based on the reputation of the parent organization. On the other hand, if the social enterprise is mature, at or near break-even and has significant assets reflected in its balance sheet, the enterprise may be able to leverage borrowed funds. As a social enterprise develops it needs to professionalize and diversify its funding base from typical nonprofit donors to seeking money from quasi-formal and formal sources that will introduce financial rigor and accountability. Once the enterprise has reached a certain scale, working capital and fixed asset requirements exceed the reserves of the parent organization and fall outside the parameters of traditional donor funding.

Commercial banks in general are dubious about lending to social enterprises, yet venture philanthropists, development banks, community development funds, municipal governments and progressive donors are increasingly making soft loans to social enterprises. These may be either interest-free loans or subsidized loans at below market interest rates. Nonetheless, for bank borrowing low debt to equity ratios and break-even are usually requirements. Banks also scrutinize cash flow statements to ensure that the social enterprise has the capacity to repay the loan on a regular schedule. Capital assets such as building and land can also serve as collateral to secure a loan or line of credit at market rates. Traditional nonprofit donors on the other hand, may cover capital assets for equipment, operating costs, parent organization overhead related to the enterprise program and technical assistance costs during startup and growth stages. And though many will not directly support the operating costs of a business beyond early phases, they will often contribute to social costs, either for capacity building or social programming. (exhibit 8I: Quantifying Social Costs). Enterprise revenue is an internal fundraising mechanism and must be allocated to costs of business operations and social costs not covered by grants. Understanding these intricacies in the funding landscape requires a considerable amount of research.

Enterprise Development Stages

Like product life cycles (chapter 5), a social enterprise passes through discrete stages of development from startup to profitable business. The stage of development is characterized by enterprise sophistication and ability to cover its costs. Conversely, it determines the type of financing the enterprise is able to secure. The table below shows this relationship.

Development Stage	Startup	Growth	Break-even⁺ Operating Costs	Break-even † Operating + Social Costs	Profitable
Timeline*	**0 - 1 year**	**1- 3 years**	**3-5 years**	**5-7 years**	**Over 7 years**
Characteristics	Small-scale enterprise pilot; testing business concept/ products in market; little or no revenue; dependence on PO for technical support; low capacity.	Success in limited market, demonstrates potential viability, research and expansion into new markets, operating loss, heavy technical support needs for capacity building and TA; PO dependence.	Established track record; proven business model; operates in several markets-still growing; income covers cost of business operations including inefficiencies and loss; social costs subsidized; PO role diminished; TA for specific constraints; capacity fairly solid.	Solid social enterprise model, sufficient income to cover operating and social costs, diversified and sophisticated, competitive business, may spin off from PO, competent staff, contracts expert TA for specific needs.	Able to cover operating and social costs plus realize a profit with internally generated revenue; professional staff and management. Often separate entity with PO members on board.
Funding Needs	PO overhead & salaries related to program; sunk costs for equipment, facilities, raw materials, cash, etc.; enterprise operations; TA; social programs; inefficiencies and loss.	PO overhead & salaries related to program; TA and capacity building; operating deficit; investment $ for: market research R&D, product development; social program costs and inefficiencies and loss.	Limited PO indirect costs; social program costs; capital assets (technology, equipment) purchases for expansion; working capital credit needs; specific TA and targeted capacity building.	Working capital (especially for capital intensive business-i.e. financial services); capital assets (technology, equipment) purchase for expansion; investment capital (new facilities or technology innovations). Limited social costs.	Working capital; capital assets purchase for expansion; possible investment financing.
Funders	PO, risk taking nonprofit donors with exiting PO or management relationship; grants are generally small and short term.	Foundations or government agencies larger size grants for multiple years. Some VPs.	Small- to mid-size foundation and government grants for social programs; in-kind TA; quasi-formal sources of soft money; VPs.	Investors, banks, quasi-formal and financial institutions, professional in-kind TA. Foundation/PO small grants for social programs not expected to cover costs.	Investors, banks, financial institutions.

*The timeline is given as a guide based upon averages from financial service businesses; country context and type of business may determine how quickly a given social enterprise passes through development stages.

⁺Enterprise covers business operating costs with revenue.

†Enterprise covers business operating costs (including financial costs of borrowed capital) and social cost (or specified social costs) with revenue.

Taking this "big picture" investment approach to social enterprise financing can be a huge departure in thinking for nonprofit professionals. Most are accustomed to tapering organizational needs to donor priorities or thinking in "grant-size" boxes- meaning that the social enterprise's financial needs are dictated by specified grant amounts rather than actual costs. SC refers to this as being donor-driven rather than market-driven. Social enterprise managers need to learn to think like for-profit managers who analyze their businesses' financial needs by using actual and realistic projected cost and then seek resources accordingly.

Securing funding is a time consuming venture requiring a significant amount of research and planning. The following three-part exercise will guide you through this process by: 1) determining the mix of funding sources in your enterprise and the uses of those funds; 2) identifying future funding sources; and 3) developing a resource acquisition plan.

Same for all three parts of* Resource Acquisition *section: business manager, accountants and finance professionals, PO business advisor and development director (and/or PO or implementing organization executive director).

Financing Mix

The first step to developing your resource acquisition strategy is to identify your uses of funds (financial needs) and their sources to determine your financing mix.

- ▲ Using historic donor records and financial statements determine the sources and uses of enterprise funds. Begin by indicating in which category funds were spent in the previous year as well as the sources of those funds (by category rather than by donor). If your venture is a startup you will have no historic records.
- ▲ Prepare a "**Financing Mix Table**," like the one in our example (exhibit AA) or use the template provided in *The Workbook*. **Financing Mix Table** should include all years covered in your business plan. **!!! Hint:** If your plan is only for one to two years, it is prudent to include an additional year or two in projections.
- ▲ From the projected, or pro forma, budget and profit and loss statements, you should have a good sense of what funds will be needed and how you will use these funds.
- ▲ Fill out the "Uses" section of the table.
- ▲ Total the amount of funds needed identified in the "uses" categories.
- ▲ Next, discern sources that are **obligated** for the current period (in our example funding is committed for business plan year 1 and how you plan to use these funds. Depending on your current funding situation **non-obligated** sources other than projected income sources (from pro forma and profit and loss statement) may be less obvious than uses.
- ▲ Fill out the "sources" section of the table as completely as you can. Gaps will indicate what you will need to find money for, and how much you need. Additionally, it will help you identify potential funding sources.
- ▲ Total the funding gaps. Once you have completed the following exercise, **Identifying Funding Sources**, you will return to the table.

<u>Sources and uses of funds information is included in the Business Plan.</u>

EXHIBIT 8AA: TARTINA ENTERPRISE'S FINANCING MIX

Sources/Uses of Funds	Historic (Previous Year)	Year 1 (Business Plan)	Year 2 (Post B-Plan Period)
Uses:			
HQ/Parent Overhead (+ internal TA-salaries)	$102,390	$155,184	$80,560
Technical Assistance (external contractual)	15,828	41,766	57,800
SE Operating Costs (+ salaries; w/out TA)	40,639	62,809	88,652
Capital Equipment	116,000	10,970	15,600
Working Capital	-0-	25,000	70,000
Financial Costs (borrowed capital)	-0-	-0-	-0-
Capacity Building	6,037	8,616	11,320
Social Program Costs & Loss Compensation†	61,270	49,412	36,040
Total Resources Needed	**$342,164**	**$328,757**	**$359,972**
Sources:	**(obligated)**	**(obligated)**	**(non-obligated)**
Income	-0-	$15,922	$48,678
Grants	$280,000	220,000	116,500
PO Match	62,164	47,835	-0-
In-Kind*	-0-	20,000	40,000
Soft Loans	-0-	25,000	50,000
Investment Funds	-0-	-0-	75,000
Commercial Loans	-0-	-0-	-0-
Total Sources Identified	**$342,164**	**$328,757**	**$338,678**
Funding Gap	**-0-**	**-0-**	**$29,794**

†In TARTINA's example loss compensation and social program costs are combined. Normally these costs should be segregated.

*Estimated value for in-kind contributions for services or assets.

Donor-Investor Research

Nonprofit organization development professionals are generally competent in identifying traditional funding sources within the donor community, such as private and corporate foundations, government agencies and multilateral organizations. They are, however, largely ignorant of nontraditional sources of funds.

Some examples include: community banks (or those with a portion of their portfolios dedicated to community reinvestment), venture philanthropists (VPs), development banks, economic development funds, HUD loans, Small Business Administration (SBA) loans, municipal government programs, donor venture or social investment funds, universities and corporations (often fund or donate in-kind support for R&D, market research, product development, technical assistance), etc. Appropriateness of these different sources depends upon enterprise location, type of business and development stage. The research period may take several weeks. Information can be gathered through networking with other social entrepreneurs, annual reports of similar programs; libraries, foundation centers and donor directories; attending industry conferences; contacting lenders, venture philanthropists and foundations regarding their funding or other sources they know. The development department of the parent organization along with board members should supply entrees to individual donors. Small business services (SCORE, Women's Business Development Centers, etc.), provide information on how and where to seek enterprise financing. Review social fund prospectuses (Calvert, New Profit, development banks, etc.) for sources of soft funds. Contact nonprofit organizations and universities that provide assistance (in-kind). And of course don't forget the Internet, which has become a valuable and efficient research tool available in many countries.

Same as previous exercise

Identify Funding Sources

In the previous exercise you determined how much money you will need and what you will need it for to finance your enterprise for the period covered by your business plan. In this exercise you will identify potential funding sources to meet these financial needs.

!!! Hint: *If your business plan is less than five years it helps to look beyond the business plan period when identifying future donor and investors. Remember "money begets money." Donors and investors want to know that their funding will terminate. Donors especially feel more confident giving money when they know other funding prospects exist beyond their grant period and that the enterprise is graduating to more formal sources.*

▲ Mostly, this is a research exercise into particular funding sources. Refer to exhibit DD: Donor - Investor Criteria and Applications to guide your research agenda.

- ▲ For each potential source find out the funding criteria, the approximate financial size of the support, the purpose or specified use of the funds they provide, the type of funds (grant, in-kind, loans, etc.), the potential (your chances) for receiving funds through this source. Be realistic!
- ▲ Keep notes on the preferences and interests of your prospective donors. This information has important strategic relevance for planning future resource acquisition.
- ▲ Prepare a "Funding Source List," like the one in our example (exhibit BB) or use the template provided in The Workbook.
- ▲ When you have prepared your resource list, return to the non-obligated sources section of your **Financing Mix Table** and complete the exercise based on your projections.

Be sure you are clear about investor funding preferences and terms. Most donor-investors expect the social enterprise to generate sufficient revenue to cover its social costs. They regard their investment as a limited and efficient use of funds. On the other hand, some donor-investors may award grants to subsidize social costs over the long term, accepting double bottom line profit and loss statements as a standard part of reporting. Thorough research on the funding landscape informs business planning and can help shape the design of your social enterprise. For example, Save the Children does not integrate its business programs with nonbusiness social services, in part because funding is more difficult to obtain. If SC wants to render both types of services to the same target population it runs parallel programs, seeking funding for each.

EXHIBIT 8BB: FUNDING SOURCE LIST

Type of Funds	Source	Criteria	Approx. Size	Purpose	Potential
Grants	ASSIST International current funder	Provided current funding to TARTINA; no continuation funds beyond next year.	\$220,000; total grant \$500,000 for 2 years.	Increase impact; capacity of social enterprise to be sustainable.	None; will not give repeat funding.
	ASSIST/Haiti Continuation grant	Evidence progression toward break-even and sustainable business model; 25% match.	Up to 150,000 for three years; discretionary money 30,000.	Operating cost deficit; capacity of social enterprise to be sustainable.	High for \$150,000; low for \$30,000 discretionary (competitive).

Type of Funds	Source	Criteria	Approx. Size	Purpose	Potential
	French Embassy	Intention to export to France/EU.	$15,000.	Market research for exportation of products to France.	Medium; unlikely will export products in near term.
	Dutch Aid	Locally operated business, evidence of positive business trends.	$150,000; $50,000 per year for three years.	Training and capacity building of indigenous staff.	High.
	HELP2U Foundation	TARTINA is registered as Haitian business; existence of local board.	Up to $100,000 over three years.	Support development of local Haitian economy through local business creation.	Low-disorganized; slow moving; possibility for next year.
Investors	SC	49% equity stake in TARTINA; must be registered as a separate business; moving toward self-sufficiency.	Up to $75,000 interest free, repayment schedule after break-even.	Operating cost deficit; capacity building.	Medium-requires approval by SC legal department.
	TARTINA Board	Board member with financial capability to donate.	$16,500, not including SC.	Unspecified. Can be used for operations.	High, committed
In-kind donations	Farmer to Farmer	Product development of Mamba.	$15,000	Cover professional consulting fees/travel to train staff on emulsification process.	High.
	U of NM	Development of sustainable environment program for agricultural cultivation	$25K	Cover professional consulting fees/travel to train peanut and fruit farmers in environmentally sound cultivation.	High, but deviates from program focus; adds to mission creep.

Type of Funds	Source	Criteria	Approx. Size	Purpose	Potential
	Tyler Graduate School of Management UM	Must be locally operated (but does not need to be separate legal enti-ty form PO); good experience for MBA students.	Up to $25,000.	Cover professional consulting fees for 3 graduate management students to assist with any business needs (must be predefined).	High. Excellent source.
Soft Loans	BFI Social Fund	Loan guaranteed by PO assets.	Up to $150,000 interest free for three years.	Working capital and fixed asset loans.	High, legal approval for SC to assume risk (difficult).
	Carib Development Bank	Break-even; solid cash flow projec-tion of revenue	Up to $200,000 at 3% interest for three years.	Working capital, busi-ness expansion can be used for capacity building.	Low, insufficient rev-enue; high risk.
	SC/Haiti	Cash flow con-straints	$50,000 interest free.	Working capital credit line only.	High; HQ must approve
Commercial sources	First International Bank	Borrowed against SC assets in Haiti.	$200,000 at 27%.	Business expansion and fixed asset loans.	Low; too risky for SC/Haiti.

Same as previous exercise

Resource Acquisition Plan

In this exercise you will plan your fundraising, drawing on information from the two previous exercises: how much money you need to run your social enterprise and confirmed and potential sources to meet those financial obligations.

▲ Follow TARTINA's example (exhibit 8CC: TARTINA Resource Acquisition Plan).

▲ Use research findings to support your resource acquisition plan and to convince business plan readers that you can raise the necessary funds.

Resource Acquisition Plan is included in the Business Plan.

Exhibit 8CC: TARTINA Resource Acquisition Plan

Year 1

TARTINA Enterprise needs a total of $328,757 in Year 1. $312,835 of these funds are obligated through a comprehensive central grant from ASSIST/International. Under the terms of this grant, Save the Children has committed a 30% match for $72,835, split between operations ($47,835) and a working capital soft loan ($25,000). In-kind support from Farmer to Farmer program for peanut processing and storage technology is equivalent to $20,000. The remainder will be met by projected sales revenues of $15,922.

Year 2

TARTINA Enterprise needs a total of $359,972 in Year 2. TARTINA anticipates $50,000 funding from ASSIST/Haiti for a three-year continuation grant totaling $150,000. ASSIST/International will have invested $500,000 in TARTINA and therefore continuation from its Haiti branch is probable. Dutch Aid, which has viewed SC's work favorably, is expected to fund TARTINA's capacity building and technical assistance needs, $50,000 a year for three years ($150,000). Consistent with Save the Children's social enterprise program strategy, SC/HQ will become a minority shareholder in TARTINA and provide $75,000 investment funding. Other TARTINA board members have committed a total of $16,500 for operating expenses. SC/Haiti will also plans to open an interest free $50,000 credit line to ease TARTINA's cash flow constraints. In-kind technical assistance valued at $40,000 is expected from Farmer to Farmer ($15,000) and Tyler Graduate Management School ($25,000). TARTINA has an established relationship with these service providers and is confident about securing their continued support. Moderate growth targets project TARTINA sales revenues of $48,678.

A funding gap of **$29,794** remains. TARTINA plans to pursue secondary grant sources such as HELP2U, seek discretionary monies, borrow soft funds, or trim planned activities in year 2 to bridge financial needs with available funds.

Exhibit 8DD: Donor-Investor Criteria and Applications

	Funding Criteria	Advantages	Disadvantages	Good For	Bad For
Venture philanthropists	Investment opportunities in their area of interest; innovation of project/idea; viability of business model; management expertise and skills, competitive positioning; respected board member/PO executive.	Potentially large sums available; can disburse any time; private money—flexibility; will pay overhead and start up; high accountability for results; can bring expertise to enterprise.	Emerging funder, competitive, difficult to obtain resources; can intervene/control management; funding is often given only for one year at a time. May required right connections.	Pilot programs, startup and growth funding; sophisticated or innovative enterprise, competent human resources with private sector savvy.	Inexperienced social enterprise with typical nonprofit management, or enterprise not committed to viability.
Foundations	Funding opportunities in mandated area of interest (or defined by trustees). Social impact, appropriateness of enterprise to meet needs of target population; viability of business model; management expertise and skills; reputation of PO/past funding relationship; competitive positioning.	Small to large amounts, fairly forgiving funder when results are not achieved; pays overhead and indirect costs of PO; one- to multiple-year grants; will underwrite or buy one part of program—i.e. client training.	Few foundations see funding social enterprises as a priority; competitive, difficult to obtain resources; difficult for a new social enterprise without established PO behind it. Fairly long lead time between application and disbursement.	Pilot programs, startup and growth funding; technical assistance and capacity building at any stage, will often subsidize social programs and services—i.e., job counseling and coaching.	Immediate funding needs; continuation funding for capital intensive businesses—i.e., complex manufacturing or financial services; capital assets such as heavy machinery or technology.
Government Agencies & Multilaterals	Funding opportunities in mandated area; social impact; break-even within specific period, potential sustainability, often a match on resources is required; (business income usually-counts), solid reputation of PO, fundraising plan if viability is not to be achieved in grant period; not duplicating efforts of another organization.	Large amounts often for multiple years; pays overhead and indirect costs of PO; no cost extension if underspent; forgiving funder when results are not achieved; partnership based.	Complicated application process; turnaround slow, infrequent funding cycle; reporting can be cumbersome; often based on PO reputation; low understanding of SEs; finding match money can be problematic for some organizations.	Growth to break-even level I stage of enterprise development; often will fund for long term (multiple years); excellent for PO overhead; comprehensive grants with ample resources for capacity building and social objectives; and capital intensive businesses—i.e., financial services.	Immediate funding needs; new, unknown or resource-poor organizations.

	Funding Criteria	Advantages	Disadvantages	Good For	Bad For
In-kind Contributions	Interesting learning/training opportunities for students or professionals; chances to further research agenda; none (purely altruistic)	Free! Can obtain high quality assistance or resources.	Little monetary value; low priority for donor, difficult to hold accountable for deadlines/product quality; hard to change product once complete; mixed agenda for making contribution.	Specific technical expertise; general management assistance for specific, well-defined projects;—that are not too time sensitive.	On-going technical needs, projects with tight deadlines; assignments that require revision—i.e., MIS, publications, Web sites.
Private Individuals	Good "feel good" opportunity for donor; knows executive director, or board member. Generally interested in recognition and/or appreciation.	Unrestricted money with few strings attached in terms of results, expectations or reporting.	Executive director, or board must be well-connected to people with money. Cultivation can be time consuming. Donor may have agenda—usually want to "buy" something concrete. Low amounts.	Underwriting expenses difficult to secure other monies for—i.e., market research; defined projects with visible results—i.e., equipment or facility improvement.	An immediate need if cultivation process has not started; project that requires significant capital. Intangibles like working capital or overhead.
Investors	Good business opportunities with higher return than other investment options–i.e., stock market; or (for benevolent investor) opportunity to "do good" for shared or lesser return.	Possible to get sizable amounts, in early stages may be easier to secure than from other sources providing that strong connections to investors exist. More flexible than banks or financial institutions.	Must be well connected, can be time consuming to negotiate deal, may want equity in business or to participate in decision-making, nervous investor can recall investment. Can jeopardize personal relationships. Risky.	Small to medium social enterprise to underwrite business expenses, rather than social costs; nice complement to traditional donor funding.	Social enterprises in startup or that take a long time before showing a profit.
Parent Organization	Project with high social impact, possibility to attract large-scale funding (i.e., central grants that support PO overhead).	Amounts can be sizable. Easier to secure than grants; risk is low and is not firmly hinged on results (very forgiving); if equity funding is provided will take equity stake.	Lots of internal competition for undesignated funds, release can be slow for political reasons. Repeat funding usually difficult, unless becomes PO sacred cow. Must be careful of hidden PO agendas.	High risk investments or for pilot social enterprise program in order to develop track record and attract funds. Match funds. Bridge money or equity funding for mature enterprises.	Startup or pilot stage of future large enterprise programs, capital intensive business, or enterprises that are slow to show results.

	Funding Criteria	Advantages	Disadvantages	Good For	Bad For
Quasi-Formal Lenders (soft loans)	Ability to repay loan; break-even or near break-even; loan backed by PO assets.	Introduces financial rigor and accountability in enterprise; helps establish history of credit worthiness for later bank borrowing. Semi-forgiving; subsidized interest rates.	Can spark internal wars in PO about assuming social enterprise's risk for borrowed capital; must pay interest; process can be time consuming and bureaucratic.	Working capital; capital for on-lending for financial service businesses; financing high return growth components (new processing machine).	Social enterprises prior to break-even; risky enterprises or those requiring a long time before becoming profitable.
Commercial Lending Institutions	Ability to repay loan; strong financial position, realistic cash/revenue projections; collateral; solid business model; management expertise and skills, low risk	Does not require equity stake or decision-making authority in business, no obligation for an on-going relationship once loan is repaid; definitive amount to repay.	Difficult to secure bank loans for new social enterprises, must secure with collateral; interest rate can be high; no flexibility on repayment schedule.	Established social enterprises that need credit line to fund short term cash flow, specific activities or for capital asset purchases.	Startup, on-going operating expenses, social enterprises with inexperienced management.