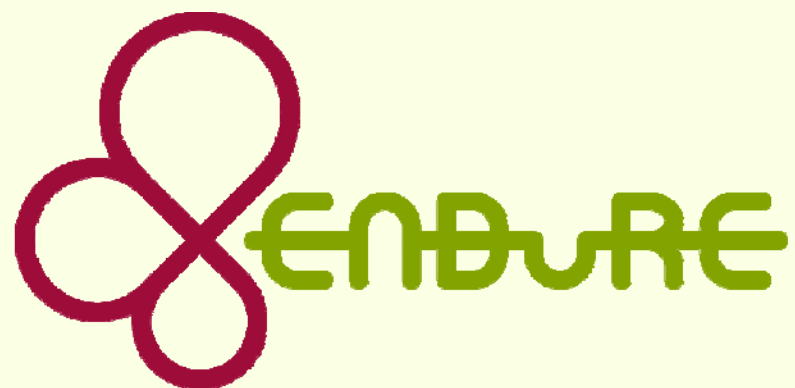




Financial Business Planning



UNIVERSITY OF
SURREY



UNIVERSITÀ DI PISA



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Financial Planning

Needs of entrepreneurs and start-ups evolve as company grows and goes through different stages:

Business idea

Initial funding

Financial planning

Financial management

Exiting



Planning - Legal Structure

Implications for Funding

Sole Trader

- Structure - easy to set up / low cost
- Initial Capital - solely owner
- Difficult to transfer ownership/raise capital
- Limited exit strategies

Partnership

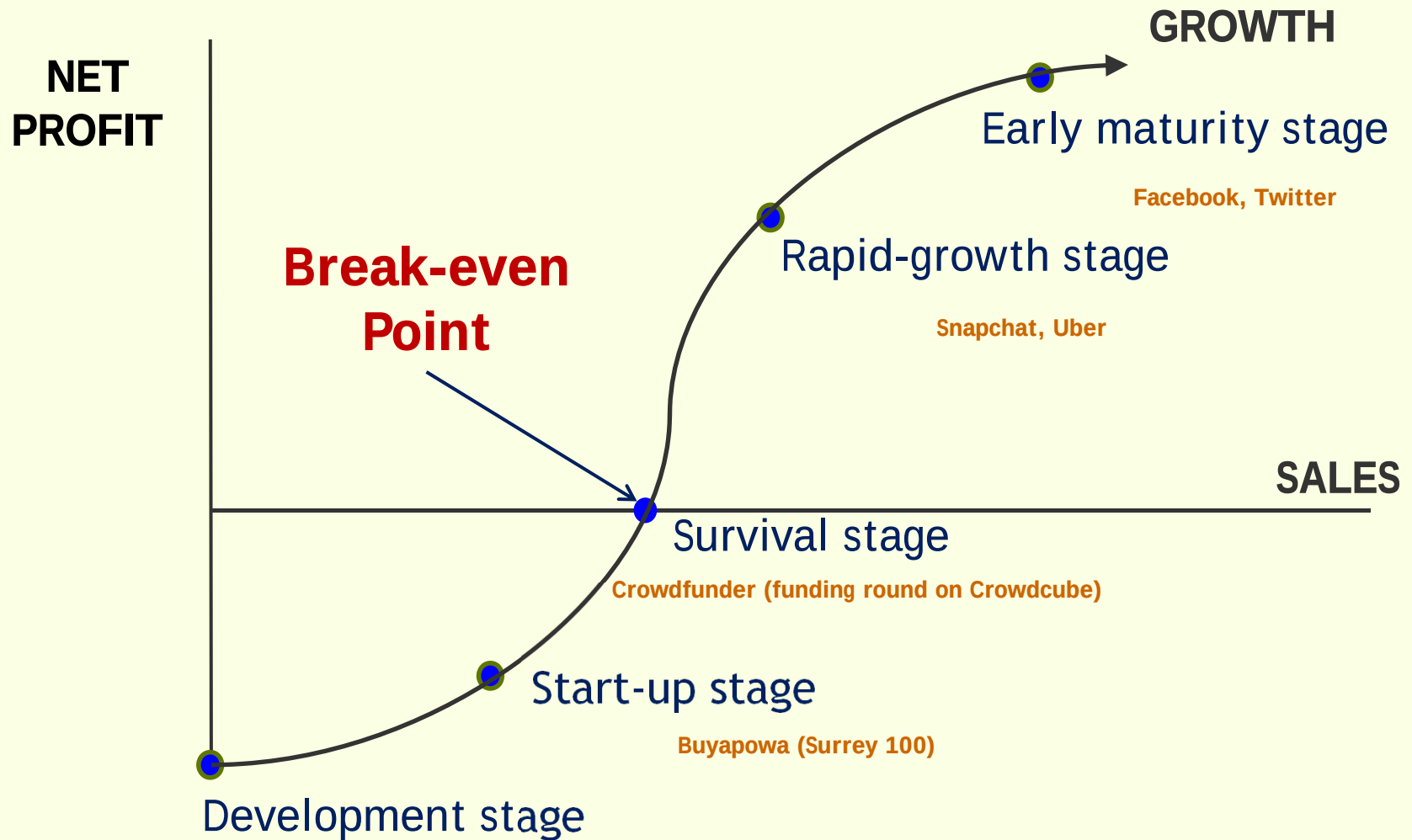
- Structure - moderately difficult to set up
- Initial Capital - 2 or more partners
- Difficult to transfer ownership
- Limited exit strategies

Limited Company

- Structure - moderately difficult to set up
- Capital - initial shareholders / venture capital
- Unlimited life / easy to transfer ownership
- Exit - series ABC, IPO, secondary market



Lifecycle



Stages - Entrepreneurial Firms

1) Development Stage

- Screen business idea
- Prepare business plan
- Obtain seed financing

2) Start-up Stage

- Choose organisational form
- Prepare initial financial statements
- Obtain start-up financing

3) Survival Stage

- Monitor financial performance
- Project cash needs
- Obtain first-round financing

4) Rapid-growth stage

- Create and build value
- Obtain additional financing
- Examine exit strategies

5) Early-maturity Stage

- Managing on-going operations
- Maintain and add value
- Obtained seasoned financing



Financial Plan

“Financial analysis
is really just the
mathematical expression
of your
overall business strategy”

Bygrave & Zackerakis (2008)



Financial Plan – Users

Business Management

Operations decisions

- R&D
- Physical resources

HR decisions

- Employment
- Compensation

Marketing decisions

- Product features
- Pricing strategy

Financing decisions

- Cash management
- Bank borrowing

Financial Plan – Users

Other Stakeholders

☐ Investors

- Investment decisions
- Monitor performance
- Pay-out decisions

☐ Business partners

- Loans
- Relationships
- Terms of business

☐ Customers

- Commercial decisions
- Terms of business

☐ Fiscal authorities

- Grants and subsidies
- Taxes and tax credits

Financial Plan – Key Questions

- How much initial capital do you need?
- What are your start-up costs?
- How do you price a product?
- How do cost and revenue drivers compare to competitors?
- Are you making money from what you thought you were?
- Ultimately, how do you value your business?

Financial Plan - Key Analysis

- Break-even analysis
 1. What are costs and revenue drivers?
 2. Where does revenue = costs?

- Pricing strategy
 1. What pricing strategy do you use?
 2. How does your pricing compare to competitors?

- Cash flow forecast & budget
 1. What are sources and uses of cash?
 2. Where does revenue = costs?

Cashflow Analysis - Methods

- ☐ Investment appraisal
 - ☐ **Cash flow forecasting & budgeting**
 - ☐ Ratio and comparables analysis
 - ☐ Financial statements
 - Income statement
 - Statement of financial position
 - Statement of cash flow
- Start-ups
- Established Companies

Cashflow Building Blocks

□ Revenue & Expenses

- How much are they?
- When do they occur?

□ Sources of Cash

- Revenue
- Liabilities & capital (funding)

□ Uses of Cash

- Expenses
- Assets (investments)

Cashflow Building Blocks

**Which is a revenue item? Is an expense item?
Which one is a source of cash? Use of cash?**

Sales receipt

Materials

Sales
credit

Revenue forecast

Factory
equipment

Employee share scheme

Product
delivery charge

Start-up loan

Research &
development

Where do you start?



Build-up Method

- ❑ Identify specific revenue and cost items
- ❑ Determine daily use
 - How many customers?
 - How much product/customer?
 - How much will they pay?
 - How often will they buy?
- ❑ Validate driver assumptions
 - Primary research (customers, trade shows)
 - Secondary research (industry and company reports)
- ❑ Recombine figures
 - Monthly & annual
 - Seasonal variations

} Drivers

Build-up Method - Exercise

BOOKSTORE

Revenue

# Visitors/day	200
Buyers/Visitors	20%
# Books/Buyer	1.5
Selling Price/Book	£30
<u>Annual Days Open</u>	250
TOTAL REVENUE	£450,000

Fixed Costs

	Monthly	Annual
Rent	£1000	£12,000
Salary	£2000	£24,000
<u>Utilities</u>	£200	£2,400
TOTAL FIXED COSTS		£38,400

Cost of Sales (Variable Costs)

Margin/Book	50%
TOTAL VARIABLE COST	£225,000

Break-even Analysis

$$\text{Costs (Fixed + Variable)} = \text{Revenue}$$

**Burn
Cash**

**Break-
even
Point**

**Generate
Profits**



Break-even Analysis

Fixed Costs

Associated with setting up or running business

Variable Costs

Directly associated with selling a good or service

Revenue

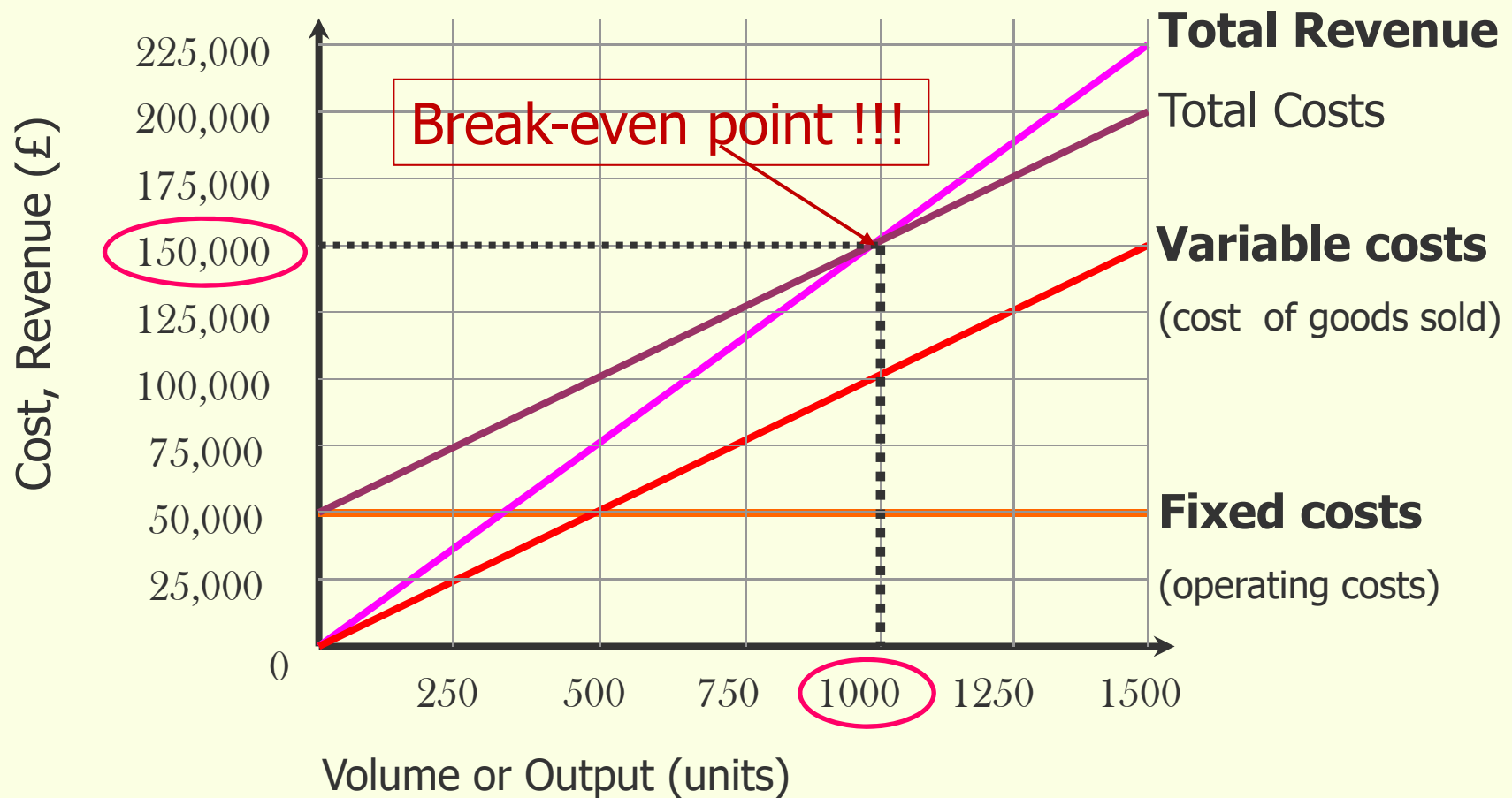
Revenue from sale of goods or service

Break-even Point

- ❑ Point where Revenue = Costs (fixed + variable)
- ❑ Business neither makes a profit or loss
- ❑ All costs covered by a particular volume of output
 - **Break-even level of output**
 - Net profit margin becomes positive
- ❑ Importance for financial decisions
 - Analysis of component parts
 - Production decisions

Break-even Point

Using the basic building blocks...



Cashflow Forecast - Use

Investigation

End-of-month cash balances

COGS sold vs. sales revenue

Cost analysis

Revenue analysis

Break-even analysis

Reasons

- Cash flow problems
- Pricing policy
- Margin trend
- Trends for fixed costs
- Trends for variable costs
- Seasonal trends
- Overall directional trend
- Runway
- Funding



Cashflow Opportunities

Economies of Scale

- Buying in bulk
- Shipping in large volume
- more efficient use of machinery/labour
- One shop sells a lot of one good

Economies of Scope

- Multiple value propositions for a single customer
- Multiple revenue streams from same transaction
- i.e. one shop sells many goods

Cashflow Analysis: Common Mistakes

- ❑ Not understanding the drivers for revenue & costs
 - What factors affect revenue?
 - What factors affect costs? Which costs?

- ❑ Underestimating time to generate revenues
 - Sales do not occur immediately
 - Sales do not move up in straight line

- ❑ Under-estimating time to secure financing
 - Investors or creditors have their own priorities
 - Venture capital vs. vulture capital

Cashflow Analysis: Common Mistakes

☐ Lack of comparables

- Need to find similar companies
- Compare ratios

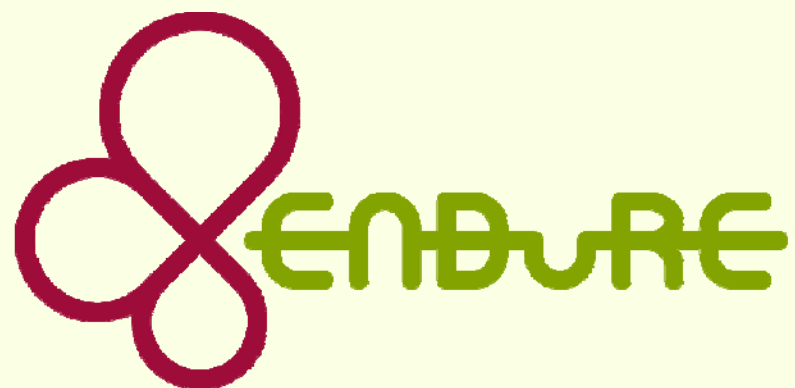
☐ Top-down vs. bottom-up forecasting

- Investors do not care about projected market share
- Investors care about process to get there

Final Thoughts

- ❑ Financial planning evolves at different stages of life cycle for companies
- ❑ Early-stage companies focus on cash burn, break-even analysis and comparables for cash flow forecasting
- ❑ Cash flow forecasting should include explicit consideration for pricing strategy and business model

Discussion



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