

## The Financial Plan

The financial plan is basic to the evaluation of an investment opportunity and needs to represent your best estimates of financial requirements. The purpose of the financial plan is to indicate the venture's potential and to present a timetable for financial viability. It also can serve as an operating plan for financial management using financial benchmarks. In preparing the financial plan, you need to look creatively at your venture and consider alternative ways of launching or financing it, for example, by relying on bootstrapping techniques.

As part of the financial plan, financial exhibits need to be prepared. To estimate *cash flow needs*, use cash-based, rather than an accrual-based, accounting (i.e., use a real-time cash flow analysis of expected receipts and disbursements). This analysis needs to cover three years, including current- and prior-year income statements and balance sheets, if applicable; profit and loss forecasts for three years; pro forma income statements and balance sheets; and a break-even chart. On the appropriate exhibits, or in an attachment, assumptions behind such items as sales levels and growth, collections and payables periods, inventory requirements, cash balances, and cost of goods need to be specified. Your analysis of the operating and cash conversion cycle in the business will enable you to identify these critical assumptions. Financial fishbones are essential to illustrate your assumptions with respect to revenues and costs.

Pro forma income statements are the plan-for-profit part of financial management and can indicate the potential financial feasibility of a new venture. Because usually the level of profits, particularly during the startup years of a venture, will not be sufficient to finance operating asset needs, and because actual cash inflows do not always match the actual cash outflows on a short-term basis, a cash flow forecast indicating these conditions and enabling management to plan cash needs is recommended. Further, pro forma balance sheets are used to detail the assets required to support the projected level of operations and, through liabilities, to show how these assets are to be financed. The projected balance sheets can indicate if debt-to-equity ratios, working capital, current ratios, inventory turnover, and the like are within the acceptable limits required to justify future financings that are projected for the venture. Finally, a break-even chart showing the level of sales and production that will cover all costs, including those costs that vary with production level and those that do not, is very useful.

### A. *Gross and operating margins.*

- Describe the magnitude of the gross margins (i.e., selling price less variable costs) and the operating margins for each of the product(s) and/or service(s) you are selling in the market niche(s) you plan to attack.

### B. *Fixed, variable, and semi-variable costs.*

- Provide a detailed summary of fixed, variable, and semivariable costs using financial fishbones

### C. *Pro forma income statements.*

- Using sales forecasts and the accompanying production or operations costs, prepare pro Forma income statements for at least the first three years.
- Fully discuss assumptions (e.g., the amount allowed for bad debts and discounts, or any assumptions made with respect to sales expenses or general and administrative costs being a fixed percentage of costs or sales) made in preparing the pro forma income statement and document them.
- Highlight any major risks (see section XI), such as the effect of a 20 percent reduction in sales from those projected or the adverse impact of having to climb a learning curve on the level of productivity over time, that could prevent the venture's sales and profit goals from being attained, plus the sensitivity of profits to these risks.

### D. *Pro forma balance sheets.*

Prepare pro forma balance sheets semiannually in the first year and at the end of each of the first three years of operation.

### E. *Pro forma cash flow analysis.*

- Protect cash flows monthly for the first year of operation and quarterly for at least the next two years. Detail the amount and timing of expected cash inflows and outflows. Determine the need for and timing of additional

financing and indicate peak requirements for working capital. Indicate how necessary additional financing is to be obtained, such as through equity financing, bank loans, or short-term lines of credit from banks, on what terms, and how it is to be repaid. Remember they are based on cash, not accrual, accounting.

- Discuss assumptions, such as those made on the timing of collection of receivables, trade discounts given, terms of payments to vendors, planned salary and wage increases, anticipated increases in any operating expenses, seasonality characteristics of the business as they affect inventory requirements, inventory turnovers per year, capital equipment purchases, and so forth. Again, these are real time (i.e., cash), not accruals.
- Discuss cash flow sensitivity to a variety of assumptions about business factors (e.g., possible changes in such crucial assumptions as an increase in the receivable collection period or a sales level lower than that forecasted).

#### *F. Break-even chart.*

- Calculate income and cashflow breakeven and prepare a chart that shows when breakeven will be reached and any stepwise changes in breakeven that may occur.
- Discuss the breakeven shown for your venture and whether it will be easy or difficult to attain, including a discussion of the size of break-even sales volume relative to projected total sales, the size of gross margins and price sensitivity, and how the break-even point might be lowered in case the venture falls short of sales projections.

#### *G. Highlights.*

Highlight the important conclusions, including the maximum amount and timing of cash required, the amount of debt and equity needed, how fast any debts can be repaid, etc.