

3.5 Write a financial plan

Components of the financial plan *continued*

5. Financial requirements and sources schedule

This will outline the amount of capital you need to raise for your business, which projected costs are being covered, and the sources for that capital—owner investment, bank or other lender, partners, etc.

6. Sensitivity analysis

When you make a sensitivity analysis, you ask “what if my underlying assumptions are off?” For instance, what if you end up with 15% fewer customers than you had projected? What if your costs increase by 10%? What if your price is set too high? What if the exchange rate goes against you by 5%? Take any “what if” scenario that you feel may apply to your business, and run through the numbers. Be aware that dropping your sales forecast by 15% does not necessarily translate to a simple 15% drop in net profit. The drop is usually significantly more, because many of your fixed costs remain unchanged. As you work through several scenarios, you will come to see which assumptions are the most sensitive to change. In other words, you may find that a 10% change in price up or down may not significantly alter your bottom line, but a small percentage change in number of sales will have a significant impact. Know where you are vulnerable and develop strategies to counteract the potential impact.

7. Assumptions used in preparing your forecasts

A problem with many business plans is that the words don't always add up to the figures. In other words, the business plan does not do a good job of linking information in the descriptive part of the plan (marketing, operations, and human resource plan) with the financial plan. *This linking is critical.* While writing any part of your plans and especially the financial plan, keep a list of assumptions about how you arrived at your numbers. For instance, you are developing sales projections for your highway lodge/gas station. One assumption you make is that you will pick up 5% of highway travellers gas sales, because you are one of two gas stations located approximately one gas-tank full from a community that provides full services to 10% of all travellers. Note the assumption, number it and add it to a list of assumptions in the business plan, making it easier for you to recall how you determined the numbers and for others to understand your projection. Are your projections realistic and reasonable? Wherever possible, provide documents that can support your forecasts (example: industry financial ratios and norms).

8. Additional information

Other information that you may need to provide includes business valuation or appraisal on real estate, equipment appraisals, costing, accounts payable and accounts receivable details, inventory control policies, cash control, break-even analysis, sales terms, and personal statements of net worth. Your potential lenders/investors will advise you which of these to include.

Getting further help

Do not hesitate to ask for help to develop or review your forecasts. An accountant or consultant can go a long way to steering you away from major pitfalls or unrealistic projections. There are also substantial resources available, some outlined below, to guide you through the process of writing your financial plan.

FOR MORE INFORMATION

Aboriginal Business Canada (Industry Canada)

www.abc-eac.ic.gc.ca

Business Books

Self-Counsel Press, www.self-counsel.com/ca

Business Planning Publications available from:

all major banks; Industry Canada (Aboriginal Business Canada); Business Development Bank of Canada; dāna Nāye Ventures.

Canada-Yukon Business Service Centre

307 Jarvis Street, Suite 101, Whitehorse, (867) 633-6257 or 1-800 661-0543 or at www.cbcs.org

dāna Nāye Ventures

409 Black Street, Whitehorse, (867) 668-6925
www.dananaye.yk.net

Tourism Resource Centre (online)

100 Hanson Street, Whitehorse, (867) 667-3053
www.tc.gov.yk.ca

Yukon Entrepreneurship Centre Society

411 Wood Street, Whitehorse, (867) 393-3574
www.yecs.ca

3.5 Write a financial plan

Setting and managing your financial targets

The financial plan may not be the heart of your business plan, but it is designed to ensure that cash—the lifeblood at the heart of every business—will be there when it's needed. In writing this plan, you will make forecasts of your sales, expenses, developmental costs, operating costs, cash flows and your financing needs, sources and timing. The financial plan will help you to set targets for your business and manage it once you're up and running.

A tool to raise finances

A second and equally important purpose for your financial plan is to convince potential lenders or investors to provide your business with capital. If you want the plan to work for you, it must be tailored both to your own needs and to the needs of your financing sources. All lending institutions will give you information about their specific requirements. Many of them have their own publications which can guide you through the process of preparing your financial plan. Other agencies such as the Canada-Yukon Business Service Centre and dāna Nāye Ventures, can also give you a great deal of useful information.

Answering questions

Financial plans outline your projections and answer questions for you and your potential lenders or investors. In practical terms, your plan will draw together this information:

1. projected (also known as pro-forma or forecast) income statements for a 1-3 year period. Income statements are also known as profit and loss statements. If you are expanding or purchasing an existing business, you will also need to show copies of past income statements.
2. projected (opening) balance sheet. If you are expanding or purchasing an existing business, you will also need to show copies of past balance sheets.
3. projected cash flow statement—detailed by month for the first year, annually for three years
4. capital and operating budgets—details of start-up costs and capital improvements
5. financial requirements and sources schedule
6. sensitivity analysis
7. assumptions used in preparing your forecasts
8. additional information

There are four questions you should bear in mind while preparing your financial plan:

- How will the company perform?
- What will the cash position be?
- What will the financial position be?
- What significant assumptions did you make?

Sales revenue projections

The basis for most of the projections you make will be the *sales forecast*, usually prepared as part of the marketing plan. This forecast sets out how much of your product or service you expect to sell. It is derived from an analysis of your target market, the definition of your typical customers and a determination of the number of sales your business can expect to make to those customers. There are critical assumptions you will have to make along the way, especially the assumption of what percentage of the potential customers will be yours. Base these assumptions as much as possible on hard facts and figures. Since the financial plan depends on the accuracy of the sales projections and timing of cash flow resulting from sales, the integrity of the business plan as a whole will rest on these projections. Regardless of the techniques you use to make your sales forecasts, rely on your own common sense and good judgment in making your final decisions.

Bracketing your projections

The exercise of making projections is not a time for optimism. A conservative business plan will project sales lower than expected, while projecting costs higher. A good strategy here is to “bracket” your projections. Prepare both an optimistic and a pessimistic projection and then walk a path down the middle. Your potential lender or investor will likely want to see the effect of making this kind of variation to your sales projections.

3.5 Write a financial plan

Projection becomes budget

Once you have your financing in place, you need to monitor your expenditures carefully while you are setting up your operation. Compare actual costs to your projections, so that you can deal with differences quickly. When you begin business operations, your projected financial statements will be your budgets. Your actual revenues and expenses should be compared to those budgets. Be prepared to act if there are major differences.

Components of the financial plan

Let's take a closer look at the components of your financial plan as outlined above.

1. Projected Income Statement

This is a forecast of how much you expect to receive in revenues and how much you will spend over the course of the next three years or more. You will start with your sales forecast to determine revenues and also your cost of sales—that is, the goods you must purchase to make those sales. To those costs, you will add other expenses like rent, utilities, advertising, office expenses, repair and maintenance. You will also need to look closely at the cost of insurance.

Tourism businesses often have unique insurance needs that can be costly for the business owner. The bottom line, your net income, equals your projected revenues minus your projected expenses. Sometimes, your first few years will show a very low or even negative net income. Projections over 3-5 years, however, may well indicate long-range feasibility for your business.

2. Projected Balance Sheet

A balance sheet is merely a schedule laying out your assets and the liabilities you incurred to buy the assets or generate revenue, as well as the equity you have in the business. This will contain the same asset and liability accounts as your "real" business balance sheets will do, once the business is up and running.

3. Projected Cash Flow Statement

Net income does not equal cash. Businesses can fail due to lack of cash even when they are showing strong sales and profitability. This profit, for instance, can be tied up in accounts receivable, equipment and inventory—leaving no cash to pay the bills. Preparing this forecast is to simply list all the cash payments and cash receipts you will make and receive, at the times you expect to make and receive them. This will show you, month by month, when you will need additional financial resources so that you can make appropriate arrangements.

When listing your cash receipts, remember that they go beyond mere cash sales to include long-term loan proceeds, sale of assets and capital infusions from owners or shareholders.

Your cash payments fall into three categories. The first is **development costs**, which are usually one-time and associated with starting up the business. They include such things as preliminary research and marketing costs, licenses, legal and accounting fees. The second is **fixed asset costs**, which are often incurred at start-up

Sample Projected Income Statement for the year ending Dec. 31, 2007, for:

Riverside Bed and Breakfast

REVENUE		
ACCOMMODATION SALES		
Swan Room	29,000.00	
Falcon Room	27,500.00	
Teal Room	22,000.00	
Nuthatch Room	19,500.00	
TOTAL ACCOMMODATION		98,000.00
GUIDED WALKS		
Evening stroll	10,000.00	
Sanctuary walk	13,000.00	
Swan song	4,500.00	
TOTAL GUIDED WALKS		27,500.00
MISCELLANEOUS SALES		
bag lunches	3,600.00	
birding books, supplies	1,250.00	
conference bookings	14,000.00	
other	2,500.00	
TOTAL MISCELLANEOUS		21,350.00
TOTAL REVENUE		\$146,850.00
EXPENSE		
COST OF GOODS SOLD		
food	10,250.00	
toiletries, housekeeping	4,500.00	
birding books, supplies	700.00	
miscellaneous	3,000.00	
TOTAL COST OF GOODS		18,450.00
ADMINISTRATION		
accounting	500.00	
advertising and promotion	12,750.00	
bad debts	1,000.00	
depreciation	5,000.00	
insurance: liability & property	4,500.00	
interest and bank charges	2,400.00	
interest on long-term debt	9,600.00	
licenses, fees and dues	1,200.00	
office supplies	2,750.00	
repairs and maintenance	5,000.00	
telephone & utilities	6,400.00	
wages and employee benefits	48,400.00	
TOTAL ADMINISTRATION		99,100.00
TOTAL EXPENSE		\$117,550.00
NET INCOME		\$29,300.00

3.5 Write a financial plan

as well, but are tangible and have a re-sale value. They include such things as land, buildings, equipment, vehicles, and signage. The third category is **operating and maintenance costs**. These are the on-going expenses of doing business, such as rent, utilities, wages, etc.

New entrepreneurs often miscalculate cash flow timing and underestimate the working capital they require. This is most true for start-up of a seasonal tourism operation. "Working capital" is the cash your business has available on a day-to-day basis to keep going. Your financial projections should show that you have allowed enough time to establish your customer base. You also need to show enough working capital to carry you through that first period of operation—when you will likely have reduced revenues and no profitability.

One of the potentially troublesome aspects of cash flow management is "accounts receivable." If your business will be invoicing customers and waiting for payment, you will have accounts receivable. It will often take 60 days or longer to get payment from a customer, even when your invoices state "net 30." If your financial plan assumes that you will receive payments within 30 days, you may run into a serious working capital shortage. Some businesses can establish credit terms with suppliers (also known as "accounts payable" or "trade credit") but most new start-up businesses have to work on cash payment terms at first.

4. Capital and Operating Budgets

How much will you have to spend before you can open your doors for business? Which costs are estimates, and which are firm quotes? Funds may be needed for purchasing equipment, buildings, inventory, leasehold improvements and furniture. This will form your capital budget—a forecast of the money you need to purchase tangible assets. The operating budget is a forecast of the money you will need for the day-to-day operation of your business. Don't overlook pre-opening costs including legal and accounting fees, loan fees, insurance, deposits, business license, stationery, advertising and brochures. Make sure that you provide for contingency funds to cover cost overruns or unforeseen costs.

Sample Projected Cash Flow Statement for the first three months of operation for:

Riverside Bed and Breakfast

	April, 1999		May, 1999		June, 1999	
	planned	actual	planned	actual	planned	actual
CASH RECEIPTS (cash entering the business)						
Cash on hand	4,000	—	—	—	—	—
Cash Sales	3,000	—	7,500	—	11,500	—
Accounts received	—	—	500	—	3,000	—
Bank loan proceeds	20,000	—	—	—	—	—
Other proceeds	10,000	—	3,000	—	—	—
TOTAL receipts	32,000	—	11,000	—	14,500	—
TOTAL cash	37,000	—	11,000	—	14,500	—
CASH DISBURSEMENTS (cash leaving the business)						
Accounting	300	—	—	—	—	—
Advertising and promotion	7,500	—	1,750	—	1,250	—
Birding books, supplies	600	—	—	—	—	—
Capital expenditures	18,500	—	2,500	—	1,000	—
Food	700	—	800	—	1,000	—
Housekeeping supplies	1,200	—	200	—	300	—
Insurance	2,250	—	—	—	—	—
Interest and Bank charges	200	—	200	—	200	—
Owner's withdrawal	—	—	—	—	1,500	—
Licenses, fees and dues	700	—	300	—	—	—
Miscellaneous supplies	800	—	100	—	100	—
Office Supplies	800	—	—	—	100	—
Payment, long-term loans	800	—	800	—	800	—
Repairs and Maintenance	—	—	—	—	1,000	—
Telephone & Utilities	500	—	400	—	300	—
Wages, employee benefits	4,000	—	4,000	—	4,000	—
TOTAL disbursements	38,850	—	11,050	—	11,550	—
RECONCILIATION (to show short term financing requirements)						
Total Cash	37,000	—	11,000	—	14,500	—
Minus total disbursements	38,850	—	11,050	—	11,550	—
Surplus or [deficit]	[1,850]	—	[50]	—	2,950	—
Increase or [decrease] in short-term loan	1,850	—	50	—	[1900]	—
Closing cash balance	0	—	0	—	1,050	—
Short-term bank loan balance at month end	[1,850]	—	[1900]	—	0	—

Sample Projected Financial Requirements/Sources Schedule for:

Riverside Bed and Breakfast

FINANCIAL REQUIREMENTS

Construction costs for room upgrades, 2 en-suites, hot tub & deck	34,000.00
Signage, landscaping, gazebo viewing platform, walkway construction	16,000.00
Framed bird prints, carvings, birder's library, audio & video, 2 spotting scopes	7,500.00
Logo and collateral materials development, marketing campaign	12,750.00
Bedroom, dining room, bird room furnishings	28,000.00
Computer, printer, fax machine, desk, filing cabinet, office materials	5,000.00
Operating costs until break-even	16,000.00
TOTAL financial requirements	119,250.00

PROPOSED FINANCING

Second mortgage	32,500.00
Bank loan	42,000.00
Line of credit	10,000.00
Trade credit	750.00
Family investment	16,000.00
Owner investment	18,000.00
TOTAL proposed financing	119,250.00