Understanding the Financial Side of Your Business Plan

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VIRGINIA SBDC
LONGWOOD UNIVERSITY

Learning Objectives

- Understand the importance of "knowing your numbers"
- Understand the key components of the financial section of your business plan
- Understand key talking points for investors and bankers
- **Be able to communicate the expected financial needs AND performance of your business in your plan**

- Homework
  - For Review - Take the 30 minute SBA Course - Introduction to Accounting
    - https://www.sba.gov/tools/sba-learning-center/training/introduction-accounting

Income
cash flow

Put yourself in the investor's chair!

If your neighbor wanted you to invest in their new business idea, what would you want to know?

- About their business idea?
- About them?

Remember - This is YOUR hard earned money they are asking for!

Things you NEED to know about the business before investing

- The Business Idea
  - Who is going to buy their product or service? How do you know for sure? What makes this product or service different from other options? (Market/Competitive Advantage)
  - Is the product or service something that has long lasting appeal? Is it scalable/adaptable? Or is it only a trend? (Product Lifecycle)
  - **Can they supply the product or service at a price that the customer is willing to pay AND is profitable for the business? (Cost of product, labor, overhead - are ALL the costs identified?)**
  - **How much debt will the business have to carry beyond startup, and is this sustainable?**
  - **Can the cash flow of the business sustain the owner's personal financial requirements as well as the lender/debt requirements long term?**
- The Person/Management
  - **Do they have the capacity to take risk themselves? How much are THEY investing?**
  - Do they have the experience to start and run this business? Who is on the team?
  - Do they have the commitment to weather the long hours - startup and beyond?

What You Need to Know and Present Financially (Handouts of Examples):

- Startup Costs
- Source and Application of Funds (What is personally invested vs. what is borrowed)
- Monthly Income Statement
- Monthly Cash Flow Statement

- Assumptions you made in preparing the statements

Start-up Costs vs. Monthly Operating Expenses

- Worksheet #2 = Startup Costs

  Expenses incurred before you open the business
- Worksheet #3 = Monthly Operating Costs

  Expenses incurred monthly – to keep the doors open

Source and Use of Funds

- Defines two things:
  - Detailed startup costs
  - Source of funds to pay for startup costs
- Also functions as your beginning balance sheet

Source and Use of Funds Statement			
Assets (Use of Funds)	Loan	Equity (owner investments or other)	Total
Inventory	$5,000	$2,500	$7,500
Equipment	$5,000		5,000
Fixtures	3,000		3,000
Cash Working Capital		$2,000	2,000
Total	$13,000	$4,500	$17,500

Source and Use of Funds AKA Beginning Balance Sheet

Assets		Liabilities	
Current Assets		Current Liabilities	
Cash	$2,000	Accounts Payable	$0
Inventory	$7,500	Current Portion LTD	$2,136
Total Current Assets	$9,500	Total Current Liabilities	$2,136
Fixed Assets		Long Term Debt	
Equipment	$5,000	Bank Loan - LT Portion	$10,864
Fixtures	$3,000		
Total Fixed Assets	$8,000	Total Liabilities	$13,000
		Equity	
		Owner's Investment	$4,500
Total Assets	$17,500	Total Liabilities and Equity	$17,500

The Language of Accounting Balance Sheet

- **Balance Sheet**
  - Snapshot of your business
  - Outlines the financial condition of your business at a specific point in time
  - Provides a financial perspective by highlighting what you own, and what you owe to other parties
- Assets = Liabilities + Equity
  - Assets = Things your business owns
    - Current Assets - Can be converted to cash within a year. Ex. Cash, Inventory, Accounts Receivable
    - Fixed Assets - Property and equipment used in the business. Ex. Buildings, Machines, Fixtures

The Language of Accounting - What Your Reports Reveal

- Assets = Liabilities + Equity
  - Liabilities - What your business owes
    - Current Liabilities - Debts that are typically paid within a year's time. Ex. Accounts Payable, Current portions of long term debt (due within the year).
    - Long Term Liabilities - Debts that will be paid over longer terms than one year. Ex. Mortgages, other bank debt.
  - Equity - The part of the assets that the owner has claims to after all debts are paid. Includes capital paid in by owners as well as income from the business that is carried over from prior years or reinvested in the business.
  - The balance sheet and the fundamental equation shows HOW your business assets are funded - how much has been financed vs. purchased with owner's capital. Your beginning balance sheet could be called "Sources and Uses of Funds" and is often used to show a banker how much is being requested in loans vs. invested by you.)

The Language of Accounting: Income Statement

- Income Statement
  - Used to track sales and expenses during a particular period
  - Called a Profit and Loss (P&L) statement
  - Tells you if your business is profitable or not
  - Shows your income earned and expenses incurred

(Income - cost of sales = gross margin)
- fixed operating expenses = net profit

Income Statement

Income Statement	Month 1
Sales	$5,000
**Minus Cost of Goods Sold (Cost of Inventory Sold During the period)	$2,500
Gross Profit	$2,500
Operating Expenses	
Utilities	$100
Phone	$75
Rent	$1,000
Insurance	$100
**Interest	$57
Miscellaneous	$50
Total Operating Expenses	$1,382
Net Income (Gross Profit minus Operating Expenses)	$1,118

**Net Profit IS NOT THE SAME AS CASH FLOW!!!!

Cost of Goods Sold

Beginning Inventory
+Purchases
= Goods Available for Sale
Minus Ending Inventory
= Cost of Goods Sold

What is My Breakeven Sales Volume? (Worksheet 6)

- Total operating expenses of $1,382
- Variable (Inventory cost) of 50%
- Contribution Margin = 1 - Variable Cost %
  - 1 - .5 = .5
- Breakeven $ volume = Fixed Costs divided by Contribution Margin
  - $1,382 / .5 = $2,764 Monthly sales volume

The Language of Accounting: Cash Flow Statement

- Cash Flow Statement
  - Keeps track of the cash flowing through your business
  - Presents where the money is coming from and how it is being spent
  - Should **NEVER** have a negative ending cash balance. If you have a negative ending cash balance it means you are bankrupt or out of cash.
  - One of the most important documents in managing a small business and should be used as the primary financial statement.

More than 51% of all businesses that file for bankruptcy protection in the United States are profitable on their income statements.

Cash Flow Statement

Cash Flow Statement	Start - up	Month 1	Month 2
Beginning Cash Balance	0	$2,000	$2,482
+ Cash Receipts:			
Sales/Accounts Rec.		$5,000	
Cash Injected	$4,500		
Loan Proceeds	13,000		
= Total Cash Available	**17,500**	**$7,000**	
- Cash Paid Out:			
Inventory Expenses	7,500	$3,000	
Operating Expenses		$1,382	
Debt Repayment (Principle)		$190	
Asset Purchases	8,000		
= Cash Paid Out	**$15,500**		
Net Change in Cash	**$2,000**	**$482**	
Cash Position Ending	$2,000	$2,482	

Pulling it all together - Preparing the financial section of your business plan

- Financial History (If this is an expansion vs. a startup)
  - Three year financial history. (Tax Returns are best)
    - Income Statements
    - Balance Sheets
  - Gather worksheets from http://sbdc-longwood.com/business-planning/

    Worksheet templates can be found at this site under "Financial Projection Tools." These will be a good guideline, but you can create your own forms as long as they have the same basic elements.
    - Startup Costs Worksheet
    - Monthly Operating Expenses
    - Income Statement Worksheet and Instructions
    - Cash Flow Statement worksheet and Instructions

Pulling it all together – Preparing the financial section of your business plan

Use the worksheets (these or your own) to create the following content:

- **Source and Use of Funds Statement (Initial Balance Sheet)**
  - Use the Startup Costs Worksheet as a guideline
  - Research your startup costs carefully and list what you need to purchase/expend to open your business.
  - **Determine how much of this can be funded by various sources - remember the equation: Assets = Liabilities + Equity. All business costs are funded by either debt or equity investment. Investors and lenders will be analyzing this to see if you have done your homework well and if the ratio of debt to equity is reasonable. Work with your SBDC consultant if needed to help prepare. Remember this process is flexible. Once you create your first year income statement and cash flow projections, you may need to adjust the amount of cash necessary in the beginning to make sure your business starts strong.**
- **Income Statement Projections - 2 years of monthly projections**
  - **Projections should consider seasonal fluctuations in monthly revenue**
- **Cash Flow Statements - 2 years of monthly projections**
- **Assumptions made in preparing the statements**

Pulling it all together – Preparing the financial section of your business plan

Other Resources:

Advanced financial templates for "spreadsheet lovers"
https://www.score.org/resource/financial-projections-template

Amortization schedule for projecting loan interest and payments
https://www.score.org/resource/loan-amortization-schedule

SBDC Consulting - Free coaching on financial projections
Lin Hite - SBDC Western Region (Course Instructor)
Michael Scales - SBDC Western Region Business Analyst

Call our main office to be connected to any of our consultants (434) 395-2086

Begin with the End in Mind (Successful Pitch)- Key Focus Areas for Investors and Bankers

- Is the idea/product/service something customers will pay for? How do you know? (Do your market research. This is a key part of your pitch!)
- Are your revenue projections reasonable?
  - Have you done enough research with your customer base to justify the projected revenue?
  - Have you researched the seasonality of your business and considered this in your projections?
- Are your cost projections reasonable?
  - Have you researched your industry to understand key expense/cost factors?
  - Have you researched your startup costs well and gathered quotes?
- Are your expectations for financing reasonable?
  - The bank or investor does not want to take all of your risk - owner investment is key.
  - Consider the total financing or investment you need (outside of this grant opportunity). Present your plan to successfully raise the proper amount of investment.
  - Consider available collateral when analyzing loan structures.

Final Thoughts

Use the resources available to you!

Do as much market research as possible! - Talk to your customers.

Ask for help/advice!

Don't wait until the last minute!

Get coaching from the SBDC

434-395-2086