UNIT 12 DEVELOPMENT OF BUSINESS PLAN

Structure

12.0 OBJECTIVES

After studying this unit, we should be able to:

- Understand and define need for a business plan;
- Explain components of a business plan;
- Describe a business plan;
- Understand manpower requirement and operations of a business; and
- Understand marketing and financial aspects of a business.

12.1 INTRODUCTION

Planning is an integral part of any business. For a business to be successful entrepreneur should have a clear idea about his strengths, of his probable customers, their needs and expectations, and competitors in the market place. Before setting up a business, a document is made for defining the steps or things required to be executed to legally set up a business. This written document is called as business plan.

Business plan helps us put our thoughts and ideas on paper in a clear, systematic and convincing manner. It helps you to raise for your business. Business plan should be complete, well organized and should be based on facts. It helps focus on key points. Business plan is made by the entrepreneur himself. However, outside consultants can be hired to set the plan in a systematic written format.

The business plan can be shown to financiers to encourage them to invest money in a company. In this chapter, we will learn various aspects of business plan, components of business plan and how it is written.

12.2 WHY IS BUSINESS PLAN NEEDED

Planning is important for any business to be successful. Mostly, a business fails due to lack of efficient planning. Business plan helps to understand the business in a systematic way so that not even a single point is missed out. Now the next question that comes in our mind is that what is the need of making a business plan? The following points will help us to give the answer to this question:

1. Business plan helps the business owner to concentrate on the objectives and think about the critical requirements of that particular business.
2. Business plan also helps to set guidelines and milestones in a written format.
3. It helps to focus ideas and study chances of the growth of a business.
4. It serves as an operational tool which gives details of the past, present and future activities of a business. In addition, it tells us which function of the business set-up will fulfill which activity to help to its desired goal.
5. Business plan helps to manage a business.
6. It is also used as a communication tool. It provides the information needed to communicate with others. It defines the business proposal, the competition and the management of the business.
7. It can also be used as a financial proposal that can be used by business/company owners to show it to financers for funding. Business plan helps to make investors understand the reason they should spend money on a company.

12.3 MAIN COMPONENTS/PARTS OF A BUSINESS PLAN

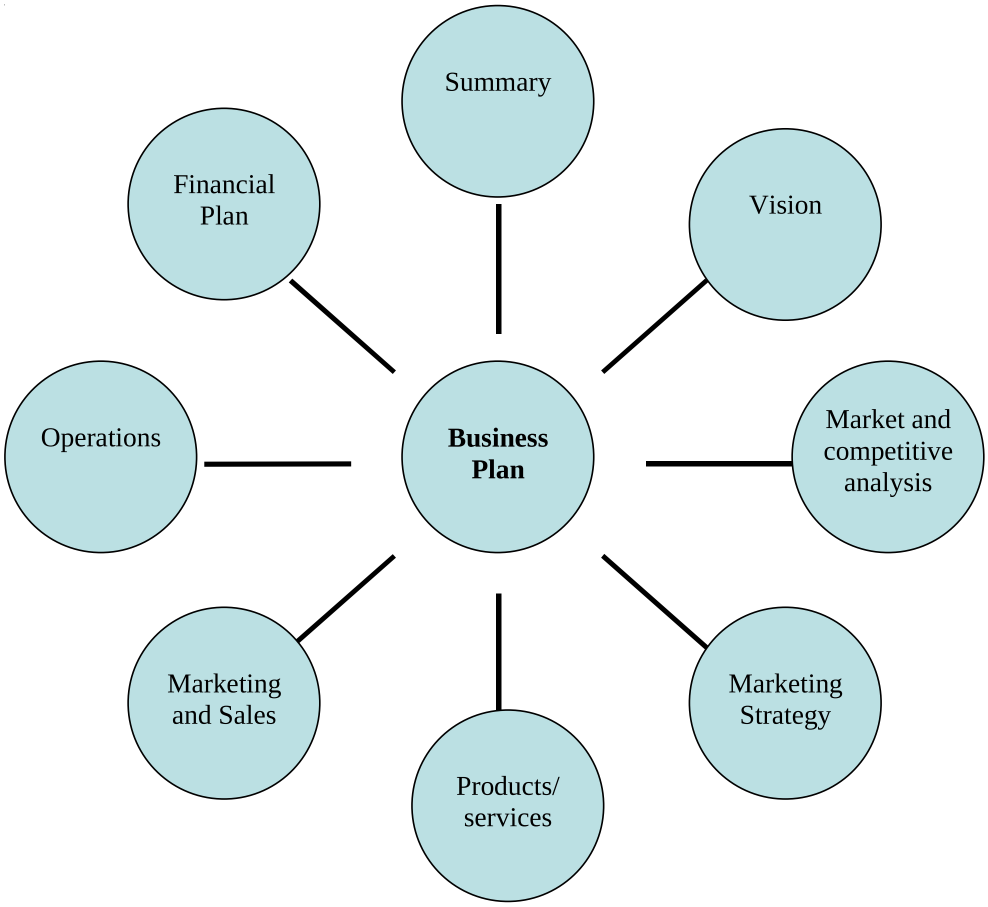


Fig 12.1 Various Components of a Business Plan

Let us discuss each of the components of a business plan in brief.

i. Summary: The first page of a business plan is summary. Summary should be concise and should cover all the essential details because the first page of a book only encourages a reader to continue reading the book. The summary should include the following points in brief:

- Company's / Business' description
- Company's / Business' objectives
- Company's products/services
- Competitors and market profile
- A statement which defines why and how the business will succeed
- Projected growth for the company
- Key management team

- Funding requirements, time-line for the funds and how the funds will be used

ii. **Vision:** Vision statement and milestones is the second main component of a business plan. Vision statement should give a clear mental picture of the business/company owner about his business dream. Milestone should also be given to define the goal and the method to achieve the goal.

iii. **Market and Competitive analysis:** Market research data should be added to the business plan because investors like to invest money in a business which has a team with thorough knowledge of the market. Market analysis section involves:

- A general description of the market a company (businessman) is willing to enter.
- Changes in the market
- Different market segments
- Market segments and customers
- Customer characteristics and needs
- Customer buying decisions

Competitive analysis involves the detailed analysis of competitive strengths and weaknesses of you and your company. This section should explain:

- Industry overview
- Nature of the competition
- Industry changes
- Primary competitors
- Competitive products/services
- Opportunities
- Threats and risks

iv. **Marketing Strategy:** After doing market and competitive analysis the next step is to define the strategy which you will be using to target the market and distribute your products/services. This section should explain:

- Key competitive capabilities and weaknesses
- Strategy that will be used by you
- Implementation of the strategy

v. **Products/Services:** This section explains the products/services offered by your company or what do your company intend to offer. Provide details about the need of your product in the market. This section should contain:

- Description of product/ services
- Positioning of product/services comparative to other competitors
- Future products/services, your company willing to offer

vi. Marketing and Sales: Marketing and sales section contains following points:

- Marketing Strategy that will be used by your company
- Sales tactics that will be used by your company to sell its products/services
- Advertising media that you will use to advertise your products/services like TV, newspaper, radio, hoardings, leaflets, handbills etc.
- Promotional campaigns, if any
- Publicity and trade shows, if any

vii. Operations: Operations involves the things required to implement the business idea. Operations section should explain:

- Human resources plan
- Delivery of product/services:
- Customer service
- Facilities provided by your company

viii. Financial Plans: Financial details should include the following points:

- Balance sheets – which indicates the owner's equity and your financial position
- Profit and loss statement – alternatively known as income statement, indicates your company's cash management
- Cash Flow statement – details all cash receipts and disbursements.
- Some key ratios for the projections that are made by you for the next few years

---

Check Your Progress - 1

1. Write the difference between Balance-sheet and Profit & Loss statement.

   ……………………………..………………………………………………......
   ……………………………..………………………………………………......
   ……………………………..………………………………………………......
   ……………………………..………………………………………………......

2. What are the main components of a Business Plan?

   ……………………………..………………………………………………......
   ……………………………..………………………………………………......

……………………………..……………………………………………......

……………………………..……………………………………………......

12.4 BUSINESS DESCRIPTION

Business description is your Business' / Company's vision and mission. Business description includes:

- Information about your company – who you are?
- What your company is going to offer – what you will offer?
- Which market are you going to enter into?
- Why the business idea you think to implement will be successful?

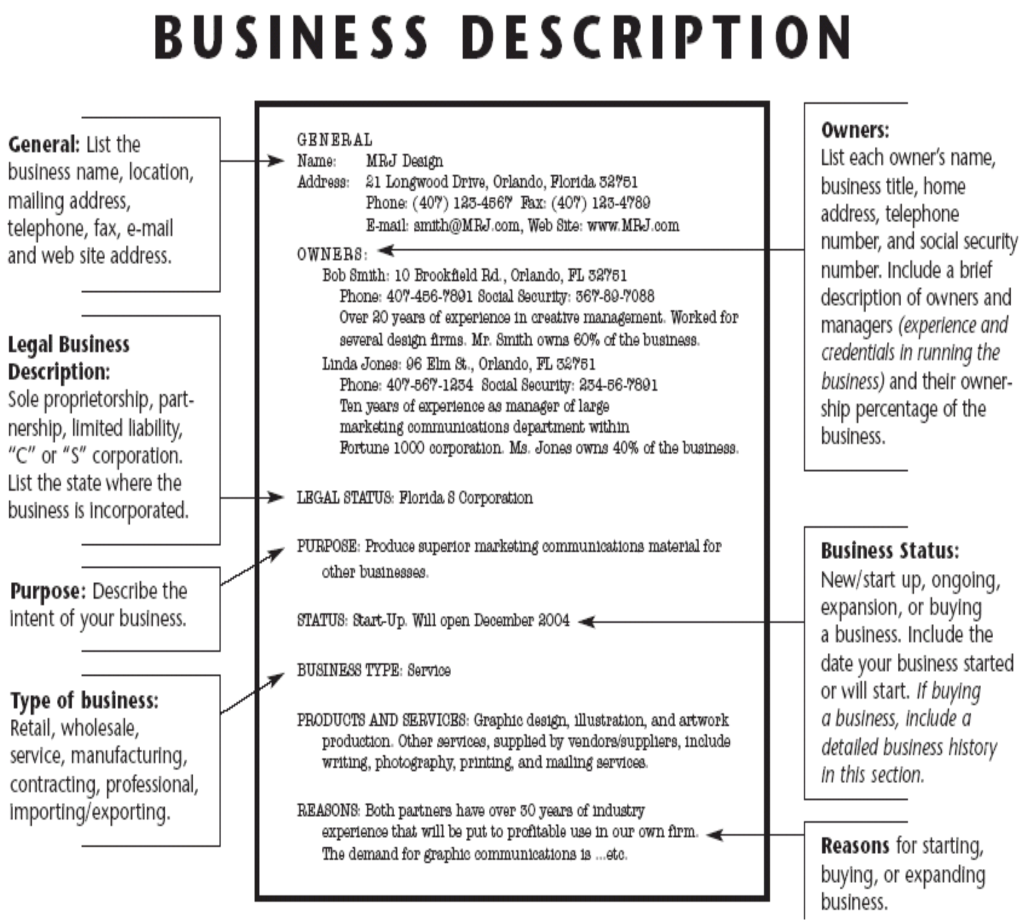


Fig. 12.2 : A sample Business Description is Shown Below in Figure.

Goals:
Include both current and long-term projections.

GOALS:

CURRENT: Bring to profitable status that will equal or exceed current income levels. Create relationships with clients. Build ...etc.

LONG-TERM: In four years, we will have 50-100 clients. Hire administrative person ... etc.

Industry:
Talk about what's going on in your industry, including economic trends, outlook, growth patterns and forecasts. Keep this section short. Explain more fully in your Marketing section.

INDUSTRY:

100 design firms and designers exist in our territory. Advertising agencies (about 255) are also competitors but their specialty is not design. Many companies have relocated to Orlando so the demand for our services is growing. The number of start-up companies numbered 6000 last year...etc.

Professional Relationships:
Include name, address, and telephone/fax numbers for your accountant, attorney, banker, insurance agent, and professional advisor(s).

PROFESSIONAL RELATIONSHIPS:

ACCOUNTANT:
Larry Stuart, CPA, 123 Main St., Winter Springs, FL 32751. Ph: 407-678-9012, Fax: 407-678-7890

ATTORNEY:
Linda Johnson of Johnson and Smith, 456 Elm St., Winter Park, FL 32789.
Ph: 407-234-5678, Fax: 407-345-6789

BANKER:
John Nelson, Heritage Bank, 678 Oak St., Orlando, FL 32908. Ph: 407-123-4567. Fax: 407-0987-6543.

INSURANCE AGENT:
Linda Doe, Doe Insurance, 321 Grove Ave., Winter Park, FL 32789. Ph: 407-432-7654. Fax: 407-876-5432

PROFESSIONAL ADVISORS:
Claire Velleca, Velleca Consultants, 1 Park St., Orlando, FL 32701 Ph: 407-222-1456, Fax: 407-419-1989

BUSINESS DESCRIPTION

GENERAL

Business name ______________________

Location ______________________

Mailing address ______________________

Phone number__________ Fax__________

Tax identification number ______________________

E-Mail address ______________________

Web Site address ______________________

PROFESSIONAL RELATIONSHIPS.

Include name, address, and telephone/fax numbers

Accountant ______________________

____

____

Attorney ______________________

____

____

Banker ______________________

____

____

Insurance agent ______________________

____

____

Professional advisor(s) ______________________

OWNERS

Provide the following information for each principal in the company.

Name______________________

Business title ______________________

Home address ______________________

Telephone number ______________________

Social security number ______________________

Include a brief description of owners and managers *(experience and credentials in running the business)* and their percentage of ownership

____

____

____

____

____

____

____

____

____

____

____

____

____

____

Legal Business Description (sole proprietorship, partnership, corporation, etc.). ______________________

State. What state is your business organized in? What states will you operate in? ______________________

Type of business (retail, wholesale, service, manufacturing, contracting, etc.). ______________________

Business Status. New, ongoing, expanding, or buying a business. ______________________

Date your business started or will start. ______________________

12.5 MANPOWER REQUIREMENT

For investors the most important aspect they consider before investing in a company is the management team. An experienced team helps in the growth of a business. The team should know about the target market, competitors, goal, and the path of achieving the goal. An organizational chart should be made to decide the manpower required by the company. This organizational chart should describe:

- Number of departments and managers required by the company
- Skills required in employees and what role will they play in the company
- Investors also consider the back-up plan i.e. in case someone who owns the business dies then who is going to repay the loans or runs the business
- Number of employees required in the company – part time and full time. As well as how many number of employees your company may require in next few years.
- How the employees will be appointed.
- Organization chart also consist of cost section which explains the salary of each employee, employee benefits and costs, and the cost of employee training, if planned.
- General section explains the expenditure incurred in outsourcing the work.

12.6 OPERATIONS AND LOCATIONS

Operations are defined as repetitive activities performed in a business to produce some product or to provide any service. Marketing, sales, production, purchasing, human resource are some examples of activities performed in a business. Operations and locations section defines how the business will operate and the factors involved in deciding a location of a company respectively. In case of a start-up discuss the critical factors for the same. In case of, retail business describe store operations, for wholesale discuss warehouse operations, for manufacturing describe factors involved in manufacturing process etc.

Operations section defines:

- The production and selling of the product
- How the services will be made available to a customer?
- The infrastructure required by the company like furniture, machines, etc. and how the company will handle it?
- The number of months, days, hours the company will be opened? And accordingly how will the employees, inventory, timings etc. will be managed.

Location is one of the most critical elements of a business. Success of any business is highly dependent on the location of a business. Location of a business is dependent on the type of business. For retailers location plays an important role, however, for manufacturing units and a wholesaler, location is not that much critical.

Factors involved for deciding a location involves:

- Space required by your company depending on the type of business.
- Desirable location and area and the cost effect on choosing that area.
- Is the location easily accessible?

- How the traffic is in that area and is sufficient parking space there?
- Zoning requirements (zoning laws)
- How safe is that area?
- The space you are considering is it owned by the company, or on lease. Provide the document required.
- For retailers:
  - Specify other competitors in that area, and other businesses running in that location.
  - Is the location easily accessible to the customers?
- For manufacturers and wholesalers and other businesses:
  - Is public transportation available?
  - Is the location near to the customers and suppliers?
- Provide summary and the blue print of the location with the business plan.

12.7 MARKETING

Marketing plays an important role in the success of any business. Before writing the marketing section of a business plan, market research and analysis should be done carefully.

According to Kotler, "Marketing is a societal process by which individuals and groups obtain what they need and want through creating, offering, and freely exchanging products and services of value with others." Marketing is "meeting needs profitably".

i. Marketing Plan

The Marketing section of a business plan includes the 4ps of marketing: product, price, place, and promotion. For finding out the market information two types of search could be performed:

1. Primary research: Collecting the information through survey by asking the customers.
2. Secondary research: Getting the information published by other sources.

For an effective market plan both researches should be done. The market plan should consist of:

- Business' vision and the plan to achieve the goal
- Current market position and your product in the market
- Details of the target audience – who is the customer, where do they stay, what encourages them to buy, how do they pay etc.

- Methods to reach the target audience – promotional activities, advertising etc.
- Market size

a) **Product:** Product sub-section should detail the following points:

  - Description of the product or service you will be offering to the customers.
  - Function and features of the product/ service.
  - How is it going to give benefit to the customers?
  - How is it different from the other existing products/services in the market?
  - What are the factors that change the demand of the product? Or when will the product be used monthly, yearly, daily?
  - Chart comparing the features (price, quality etc.) of competitors product and your product

b) **Price:** Price sub-section should consist of the following points:

  - Pricing strategy that will be used by the company
  - Product cost to the company
  - Selling price of the product – selling price should cover all the expenses incurred by the company plus the profit margin.

c) **Promotion:** This section details the promotion of the product:

  - How will the customer get to know about the product?
  - What methods will your company use so that a customer feels motivated to buy your product?
  - To promote the product, what all methods will your company use – advertising, print media, electronic media, public relations, word of mouth publicity etc. etc.

ii Market Size

After finding out who will be your customers, the next step is what would be the size of the business. Will it be a small company or large company? Market size and competition both are very important in a business plan because it helps to convince the investor that after the competition the business can still generate profits. Market size is decided after reviewing the statistical data and discussing with potential customers, distributors and sales representatives.

- Decide the market segmentation – i.e. dividing the market into different segments based on the customers need.
- What is the market size in terms of units?
- Describe the expected market share.

- Describe the market risks.

iii Market Competition

This section should give details about all the competitors. The points that can be included in this section are:

- What are the weaknesses and strengths of your competitors?
- Why your competitor is successful?
- Why will a customer buy a product from you?
- Which strategy is the competitor choosing and why?
- Why the competitor has not chosen the strategy that you have chosen?
- What are the threats from the competitors?
- Make the chart that compares the competitor's and yours product price, quality, service provided, and warranty, and other important features.

Check Your Progress - 2

1. How does drawing an organizational chart helps in making a good business plan?

   ……………………………..……………………………………………..….

   ……………………………..……………………………………………..….

   ……………………………..……………………………………………..….

   ……………………………..……………………………………………..….

2. List four factors which you would consider before deciding location.

   ……………………………..……………………………………………..….

   ……………………………..……………………………………………..….

   ……………………………..……………………………………………..….

   ……………………………..……………………………………………..….

12.8 FINANCE

Accounting system is the most critical element of a business. Many businesses fail due to improper business system. A company should hire professionals for setting up the accounting system and handling the legal matters to make the efficient system.

i. Sources

For setting up a business money is required. Now the question is where to get the money from and how will it be used. A business owner can look for the investors to invest money in his/her business.

A company owner should ask few questions to himself like:

- How much money is required for the business?
- What type of lender is required?
- Lender's minimum and maximum loan size?
- Will the lender be able to meet all the needs?
- What type of collateral is accepted by the lender?

Lenders use the following eight C's rules:

- Credit – must be good
- Capacity – owner should be able to repay the loan
- Capital – money required in the business
- Collateral – assets to secure the loan
- Character - you
- Conditions – any condition that can effect the business like financial condition
- Commitments – ability and willingness to succeed
- Cash flow – can it support the expenses and debts

Money can be obtained either through banks or through other financial institutions.

- **Banks –** In India, the banks can grouped into four categories based on the ownership structure. These categories are as follows:
    - Nationalized banks – Majority stake is held by the Government of India
    - Private sector banks – Major stake is held by private sector
    - Foreign banks – Majority stake is held by foreign shareholders
    - Cooperative banks – Majority stake is held by members of the bank

Banks provide financial assistance to businesses in the form of providing working capital and long term loan facility. Banks secure themselves by taking security of assets. In general, nationalized banks and Cooperative banks are more open to provide small ticket financial assistance also. Reserve Bank of India recognizes **Dairying** as a priority sector and therefore banks are more open to lending in this sector.

- **Other Financial Institutions -** Other then banks, there are other financial institutions like Development Finance Institutions (DFIs) and Non-Banking Finance Companies (NBFCs). DFIs specialize in providing long term financial assistance i.e., long term loans and NBFCs specialize in asset backed funding i.e., lending against a collateral security like vehicles, house, machines etc. In India, most of the DFIs have converted themselves into banks and only few are left – IFCI, SIDBI. Some of the well run NBFCs are Sriram Chit Fund, Sundaram Finance, Tata Finance. NBFCs are generally fast in approving a loan proposal though they may charge a higher interest rate.

The obtained money will be used for furniture, machinery, space occupied, inventory, improvements and in day to day basis activities. Your business plan should provide all the details. The business income should cover all the expenses made.

ii. Debt and Equity

Debt and equity are two types of finances. It is important to decide which kind of finance will be appropriate for your business. Lets us discuss each of them one by one:

Debt is borrowing money and repaying it with some interest over a period of time. In debt financing, the only liability of the borrower is repayment of loan on time and the lender does not get any ownership. Lenders generally require the guarantee before providing loan. Debt is usually given to a company which offers some asset that may be pledged by the lender in case of non repayment of loan. Debt financing can be of two types:

- Short term – In short term, full repayment of the loan should be done in less than a year.
- Long term – Repayment of the loan can be done in more than a year

If a company has too much debt, it becomes a risky business. Also, it becomes difficult to handle the down falls of business or any unanticipated circumstances. The other disadvantage of debt financing is that the interest has to be paid by the company under any circumstances. For a lender it's important that the loan should be repaid either through income from the business or by selling the assets.

Equity financing involves sharing of business ownership in exchange of money. In this case money is not needed to be repaid over a specific period of time. Equity can be obtained through non-professionals like family, friends, colleagues etc.

The major disadvantage of equity financing is possible loss of control over a business.

iii. Critical Factors in Taking a Loan

The points that you should consider before taking a loan are:

- A company should not over borrow the money. The money should be borrowed to the extent a company is able to repay it.
- Repayment schedule should match with the cash flows
- A company should look for more than one bank or financial institutions simultaneously before finalizing.
- If a business is large enough, or you have large personal wealth which can be used for business, then try and take loan from two banks or two financial institutions.

iv. Various Financial Statements

A financial statement is a written report which shows the net worth, assets and liabilities of a person or a company as of a specific date. Financial statements include personal financial statement, balance sheet, income statement, and cash flow statements. There are a few points to remember before making the financial statements:

- Make assumptions that are real and can be implemented in future if some risk comes.
- Show links between the past, present and future projects.
- Enough capital should be there to meet all the expenses. Ask for enough funds.
- Maintain all records.
- Keep a good financial manager to maintain accounts
- Assure the lender that loan will be repaid.

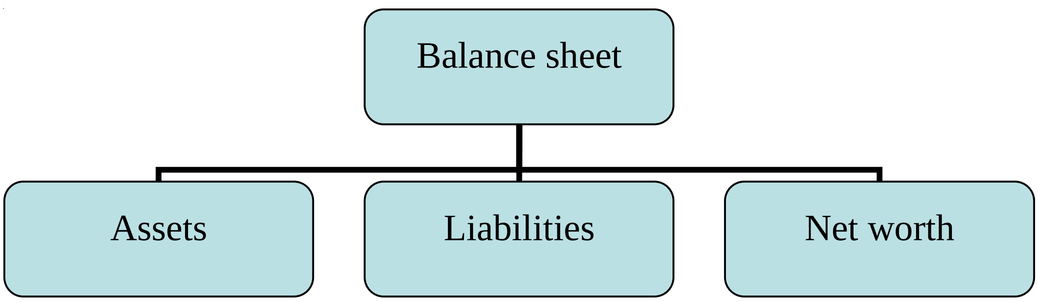
Let us discuss each of them one by one:

a. Personal Financial Statement

Personal financial statement includes financial status of each person who guarantees the loan. Financial statements should be made correctly because lenders review these statements very carefully. Sometimes lenders may ask you the questions about the risks, be ready to answer the questions. Generally the lenders provide their own personal financial statement form but usually the information asked is the same.

b. Balance Sheet

Balance sheet shows the cash position of the business and the owner's equity at a given point. Balance sheet keeps changing. Balance sheet is divided into three parts:



Assets show the things that a company or your business owns. It includes the following points:

- Currents Assets – Current assets is anything that can be converted into cash within a year.
- Account receivable – Account receivable is the amount a customer has to pay to the company.

- Inventory – Inventory is the list of goods which are there in company's stock.
- Total current assets – If we add all the current assets we will get the total current assets.
- Non-current assets – Non-current assets are the assets which take more than a year to be converted into cash.
- Fixed assets – property, plant, equipment, office furniture etc. fall into this category.
- Depreciation
- Fixed assets (net) = Total Fixed assets less Total depreciation
- Advances to owners – Advances to owners is money taken out by the owners from the business for repaying the loan.
- Total non-current assets – adding up all the non-current assets give the value of total non current assets
- Total assets = Current assets + Non-current assets

Liabilities section shows how much a company owes to others i.e. bank or other financial institutions, suppliers, employees etc. The liabilities section includes:

- Current liabilities – Liabilities that are due to be discharged with in a year.
- Current portion of long-term debt – One year's worth of loan payment.
- Accounts payable – Accounts payable is purchases made by the company for which company has not made the payment.
- Total current liabilities – Total current liabilities is sum of all the short-term liabilities.
- Long term liabilities – Long term liabilities are those that become due for payment after a year.
- Loan payable – Any amount taken from any financial institution or other sources, on which a certain interest is charged and that needs to be repaid is called loan. Loans can be short term loan or long term depending upon the duration for which they are taken.
- Total long-term liabilities – Total long-term liabilities are sum of all the long-term liabilities
- Total liabilities = Long-term liability + Current liability

Net Worth

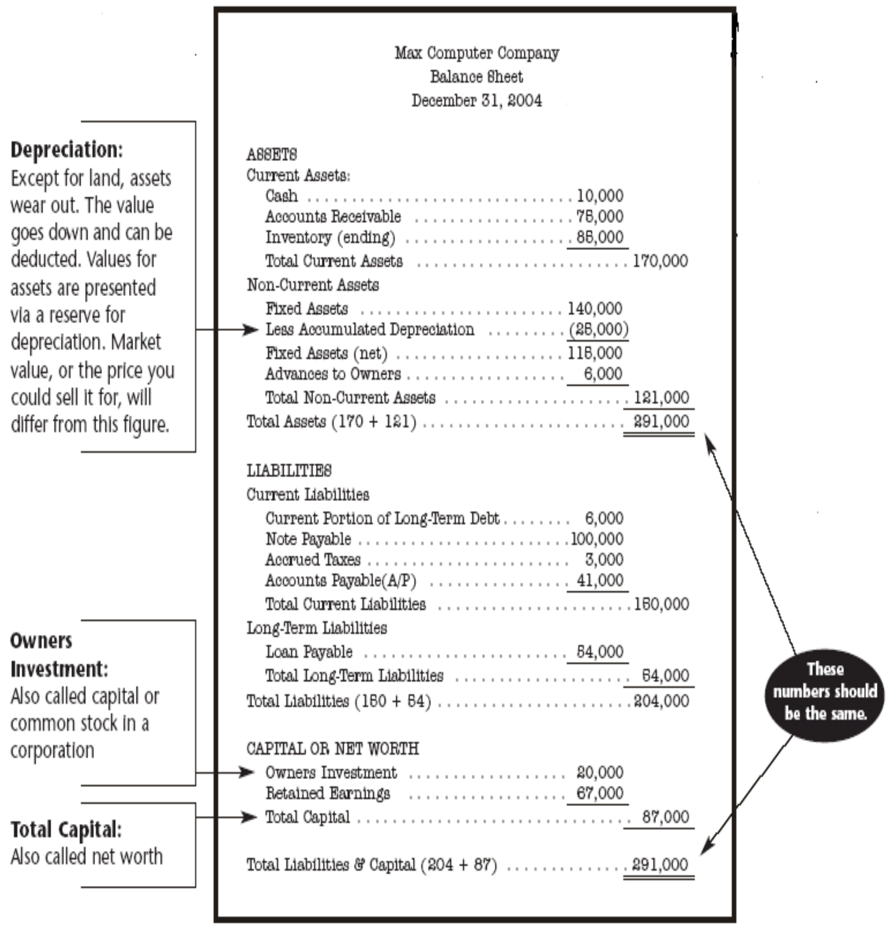
Definition for a company - Total assets minus total liabilities. Net worth is an important determinant of the value of a company, considering it is composed primarily of all the money that has been invested since its inception, as well as the retained earnings for the duration of its operation. Net worth can be used to determine creditworthiness because it gives a snapshot of the company's investment history. also called owner's equity, shareholders' equity, or net assets.

Definition for an Individual – Net worth is the value of a person's assets, including cash, minus all liabilities. The amount by which the individual's assets exceed their liabilities is considered the net worth of that person.

The net worth section includes:

- Owner's investment – Owner's investment is the money invested by the owner's in the business
- Retained earnings – Retained earnings is income earned through the business and kept in the business itself.
- Total capital = Owner's investment + Retained earnings
- Net Worth = Total Assets less Total liabilities

A sample worksheet is displayed in fig 4.

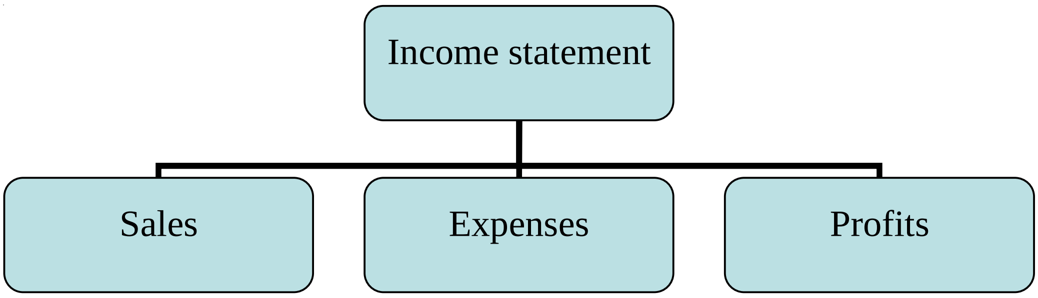


Max Computer Company
Balance Sheet
December 31, 2004

ASSETS		
Current Assets:		
Cash	10,000	
Accounts Receivable	75,000	
Inventory (ending)	85,000	
Total Current Assets		170,000
Non-Current Assets		
Fixed Assets	140,000	
Less Accumulated Depreciation	(25,000)	
Fixed Assets (net)	115,000	
Advances to Owners	6,000	
Total Non-Current Assets		121,000
Total Assets (170 + 121)		291,000
LIABILITIES		
Current Liabilities		
Current Portion of Long-Term Debt	6,000	
Note Payable	100,000	
Accrued Taxes	3,000	
Accounts Payable(A/P)	41,000	
Total Current Liabilities		150,000
Long-Term Liabilities		
Loan Payable	54,000	
Total Long-Term Liabilities		54,000
Total Liabilities (150 + 54)		204,000
CAPITAL OR NET WORTH		
Owners Investment	20,000	
Retained Earnings	67,000	
Total Capital		87,000
Total Liabilities & Capital (204 + 87)		291,000

c. Income and Expenditure Statement

Income or expenditure statement shows the financial performance of the business over a period of time. Income statement is divided into three parts.



Sales is further subdivided into:

- Net Sales – Net sales is income after returns and allowances.
- Cost of goods sold – This is the cost incurred in making the product.
- Purchases and stock – Purchases are the income used to make product or simply put total value of the inventory i.e. present raw material stock, work in progress stock, and finished good stock.
- Labor
- Total cost of goods sold – It includes the total cost incurred to make one unit of finished product. Multiplying this with the number of units produced would give the total cost of goods sold. The simple formula for calculating COGS is - Opening inventory + additions during the year less year end inventory.
- Gross profit margin – It is defined as sales realization less cost of goods sold.

Expenses are subdivided into:

- Selling expenses – Salaries and expenses incurred on sales
- General and Administrative – All expenses incurred to run the company
- Operating income – Shows how the business is performing
- Interest expense
- Net profit before taxes – Income tax depends on the legal status of the business

Profit section shows profits made by the company after paying up all expenses.

A sample income statement is shown in figure12.5.

Net vs. Gross Sales
Gross sales is the amount before adjustments (like returns and allowances). The adjusted figure is Net Sales.

Operating Income:
Gross Profit less Selling Expenses and General/ Administrative Expenses.

Max Computer Company
INCOME STATEMENT
December 31, 2004

SALES		
Net Sales		900,000
Less Cost of Goods Sold:		
Beginning Inventory	75,000	
Purchases	350,000	
Labor	200,000	
Total	625,000	
Less: Ending Inventory	- 85,000	
Cost of Goods Sold (625 less 85)		540,000
GROSS PROFIT (900 less 540)		360,000
EXPENSES		
Operating Expenses:		
Selling Expenses	90,000	
General & Administrative	170,000	
Total Expenses		260,000
Operating Income (360 less 260)		100,000
Interest Expense		20,000
PROFIT		
Net Profit before taxes (100 less 20)		80,000
Less: All Income Taxes		27,000
Net Profit (80 less 27)		53,000

Date:
Represents activity for an entire period, at the end of that time period.

$75,000 was the ending inventory for the previous year and became the beginning inventory for 2004.

Important Note: Compare numbers in the current year's Income Statement with the previous year. For control purposes, you need to know if income/profits and expenses are going up or down.

Fig. 12.5 Sample Income Statement

d. Funds Flow Statement

Cash flow provides the details about the inflow and outflow of the cash in a business. Cash flows due to following three activities:

- Operating activities – flow of cash due to normal operations of a business like selling.
- Investing activities – flow of cash due to the purchase and sale of income-producing assets.
- Financing activities – flow of cash between owners and creditors.

In cash flow statements income is written on the top followed by the expenses and repayment of the loan. A sample cash flow statement is given in fig. 6.

Name of Business	Start-Up Costs	Month 1 FIRST MONTH'S REVENUE	Month 2	Month 3	Month 4	Month 5	Month 6	Mon
A. CASH ON HAND (Beginning of month)								
B. CASH RECEIPTS 1. Cash Sales								
2. Collections from Credit Accounts								
3. Loan or Other Cash injection (Specify)								
C. TOTAL CASH RECEIPTS (B1+B2+B3)								
D. TOTAL CASH AVAILABLE (A + C, before cash paid out)								
E. CASH PAID OUT: 1. Purchases (Merchandise)								
2. Gross Wages								
3. Payroll Expenses (Taxes, vacations, etc.)								
4. Outside Services (Outside labor)								
5. Supplies (Office & operating, not for re-sale)								
6. Repairs and maintenance								
7. Advertising								
8. Car, Delivery and Travel								
9. Professional Services (Accounting, legal, etc.)								
10. Rent (real estate only)								
11. Telephone								
12. Utilities (Water, heat, electricity, etc.)								
13. Insurance (on business property & products)								
14. Taxes (Real estate, sales, inventory, etc.)								
15. Interest (on loans)								
16. Other Expenses (Specify each)								
17. Miscellaneous (small expenses)								
18. Subtotal								
F. OTHER OPERATING COSTS:								
1. Loan Principal Payment (include equipment)								
2. Capital Purchases (Specify)								
3. Other Start-up Costs								
4. Reserve and/or Escrow (Insurance, tax, etc.)								
5. Owner's Withdrawal (income tax, etc.)								
G. TOTAL CASH PAID OUT (E18 + F1 through F5)								
H. CASH POSITION (End of month, D minus G. Becomes cash on hand for next month)								
ESSENTIAL OPERATING DATA (Items explained on page 27)								
1. Accounts Receivable (End of month)								
2. Bad Debt (End of month)								
3. Inventory on Hand (End of month)								
4. Accounts Payable (End of month)								
5. Monthly Depreciation								

Fig. 12.6 A Sample Cash Flow Statement

v. Financial Formulae

For a company it is important to find out whether it is earning profit. If a company is neither earning a profit nor a loss it is said to be operating at a break-even point. So, for a profitable business it is important to know how much more sale is required to make profit and for that break even point should be calculated. Let us take the numbers from fig. 12.5 as an example to calculate some financial formulae. (Figures are taken in rupees in the table below)

Table 12.1 Calculation of Breakeven Point

1. Determine **Net Sales**	Rs.900,000	Net Sales	100%
2. Total **variable expenses** and divide them by **Net Sales** to calculate the percentages they represent.	Rs.540,000 +Rs.90,000 Rs.630,000	Cost of goods sold Selling expenses Total variable expense	60% (540K/900K) + 10% (90K/900K) 70% (630K/900K)
3. Subtract **Total Variable Expenses** from **Net Sales** to calculate the **Margin.**	Rs.900,000 -Rs.630,000 Rs.270,000	Net sales Total Variable Expense Margin	100% - 70% 30% or .30
4. Divide **Fixed Expenses** by the **Margin** and the answer is **Breakeven Point.**	Rs.170,000 ÷ .30 Rs.566,667	Fixed Expenses Margin Breakeven amount	

This company requires sales of Rs.566,667 to break even. Even if one rupee is increased the business will become profitable and decrease of one rupee will show loss.

vi. Ratios

Financial statements help in analyzing the financial information and ratios help in making the decisions. Ratios are calculated by the lenders before making decisions. Numbers to calculate these ratios are taken from balance sheet and financial statements. Some important ratios are:

1. **Asset Management Ratios:** Asset management ratio consists of:

   a. Accounts Receivable Turnover – shows the time taken to collect the bills.

$$\frac{\text{Accounts Receivable} \times 365\ (\text{days in a year})}{\text{Net Sales}} = \text{Days taken to collect the bill (Account Receivable turnover)}$$

   b. Inventory Turnover – shows the time taken to sell the inventory

$$\frac{\text{Accounts Receivable} \times 365\ (\text{days in a year})}{\text{Cost of goods sold}} = \text{Days taken to sell the inventry (Inventory turnover)}$$

For both the turnovers lower answer is better.

2. **Liquidity Ratios:** Liquidity ratios calculate the amount of cash available to cover the expenses. Liquidity ratios consists of:

   a. Working capital – shows whether the company is in a position to pay the bills.

   Current Assets - Current Liabilities = Working Capital

b. Quick or Acid test – checks if the company can pay all the expenses without selling the inventories.

$$\frac{\text{Total current assets} - \text{inventory}}{\text{Total current liabilities}} =$$ The Answer should be one or more than 1 else it is said that the company can not pay the expenses without selling the stock

c. Current – shows a company's short-term debt paying capability.

Total current Assets / Total current liabilities = Number of times a company can pay current liabilities

3. **Debt Management Ratios:** Debt management ratios include:

a. Debt-Equity – shows if the company has enough equity. Higher the ratio better it is from a lender's perspective. Lenders prefer if this ratio comes to 2 or lower than 2.

Total liabilities / Total capital = Debt-Equity

b. Accounts payable turnover – shows how fast a company makes the payment of its suppliers.

$$\frac{\text{Accounts Receivable} \times 365 \text{ (days in a year)}}{\text{Purchases}} = \text{Account payable turnover}$$

Lower number is considered to be better.

4. **Profitability Ratios:** Profitability ratios consist of:

a. Profit margin on sales – shows the percentage of profit for each sale.

Net profit/ Net Sales = Profit margin

b. Cash flow to current maturities – shows company's capability to pay term debts after owner's withdrawals. Lenders prefer the value to be 2 or more than 2.

(Net Profit + Depreciation) / Current portion of long-term debt

---

Check Your Progress - 3

1. What are the important parts of a balance sheet?

……………………………..……………………………………………….......

……………………………..……………………………………………….......

……………………………..……………………………………………….......

……………………………..……………………………………………….......

2. Write formulae of following ratios and also what do these ratios indicate.

a. Working capital

b. Debt-equity

c. Cash flow to current maturities

……………………………..……………………………………………..…..

……………………………..……………………………………………..…..

……………………………..……………………………………………..…..

……………………………..……………………………………………..…..

3. Which kind of bank should be approached in case of small loan requirement?

……………………………..……………………………………………..…..

……………………………..……………………………………………..…..

……………………………..……………………………………………..…..

……………………………..……………………………………………..…..

12.9 LET US SUM UP

- Planning is an integral part of any business. For a business to be successful you should have a clear idea about the strength of the company, company's customers, their need and expectation, and company's competitors.

- Business plan helps to understand and plan the business in a systematic way so that not even a single point is missed out which could be critical for the success of the business.

- The business plan can be shown to financiers to encourage them to invest money in a company.

- Main components of a business plan are: summary, vision, Market and competitive analysis, marketing strategy, Products/services, Marketing and sales, operations, and financial plan.

- Operations are defined as repetitive activities performed in a company to produce some product or to provide any service. Marketing, sales, production, purchasing, human resource are some example of activities performed in a company.

- Location of a business is dependent on the type of business.

- Market size and competition, both are very important in a business plan because it helps to convince the investor that after the competition the business can still generate profits.

- A company should hire professionals for setting up the accounting system and handling the legal matters to make the efficient system.

- A financial statement is a written report which shows the net worth, assets and liabilities of a person or a company as of a specific date. Financial statements include personal financial statement, balance sheet, income statement, and cash flow statements.

- Personal financial statement includes financial status of each person who guarantees the loan.
- Balance sheet shows the cash position of the business and the owner's equity at a given point.'
- Income or expenditure statement shows the financial performance of the business over a period of time.
- Cash flow provides the details about the inflow and outflow of the cash in a business.
- Financial statements help in analyzing the financial information and ratios help in making the decisions. Ratios are calculated by the lenders before making decisions.

12.10 KEY WORDS

Debt : Borrowing money and repaying it over a period of time

Equity : Sharing of business ownership in exchange of money

Balance sheet : Shows the cash position and the owner's equity

Asset : What a company owns

Liability : What a company owes to others

Net worth : Retained earnings and the funds given by the shareholders

12.11 SOME USEFUL BOOKS

Bob Adams, "Adams Streetwise Complete Business Plan" (Adams Media 1998)

Jerry Jinnett Pinson, "Anatomy of a Business Plan" (Dearborn Trade, 1999)

Mike P. McKeever, "How to write a Business Plan" (Paperback, 2005)

Stanley R. Rich, "Business Plans That Win $$$: Lessons from the MIT Enterprise Forum"

Joseph A. Covello, "The Complete Book of Business Plans: Simple Steps to Writing a Powerful Business Plan" (Small Business Sourcebooks, 1994)

Thomas R. Ittelson, "Financial Statements: A Step-By-Step Guide to Understanding and Creating Financial Reports" (Paperback - Feb 1998)

Gerald I. White, Ashwinpaul C. Sondhi, and Dov Fried, "The Analysis and Use of Financial Statements" (Hardcover - Dec 18, 2002)

12.12 ANSWERS TO CHECK YOUR PROGRESS

Your answer should include the following points:

Check Your Progress - 1

1) i. Balance sheet indicates the owner's equity and the financial position of the company and

   Profit and loss statement alternatively known as income statement indicates company's cash management.

   ii. There are 8 main components of a business plan. They are: Summary, Vision, Market and Competitive Analysis, Products/Services, Marketing and Sales, Operations, Financial Plans.

Check Your Progress - 2

2) i. Organizational chart helps as follows:

   - Visualize manpower at various hierarchy and skill requirement
   - Visualize salary and cost structure
   - Visualize location wise manpower requirement

   ii. Factors that should be considered before deciding the location are:

   - Cost of space
   - Any zoning laws
   - Accessibility to various types of vehicles
   - Safety and Law and order situation

Check Your Progress - 3

3) i. There are three parts of a balance sheet:

   - Assets
   - Liabilities
   - Net worth

   ii. The formulae and the description are as follows:

   a. Working capital = Current assets - Current liabilities.

      Working capital indicates liquidity position of the company.

   b. Debt-Equity = Total debt (Short term+Long term)/ Total equity

Debt-Equity indicates how much of the total capital required by the business is supported by owner's own contribution.

c. Cash flow to current maturities = (Profit + Depreciation) / Part of long term debt to be repaid in the current financial year Cash flow to current maturity indicates profitability position of the company and also its capability to service its long term debt.

iii. In case of small loan requirement Nationalized or Cooperative banks should be approached.