

## *Chapter 05*

# *Financial Plan*

This chapter discusses the followings.

- 5.1 Introduction to a financial plan
- 5.2 Activities and expenses to prior to business startup
- 5.3 Assessment of financial investment
- 5.4 Statement of expected cash inflows and outflows
- 5.5 Calculating business results

### X Overall Business Plan



## 5.1 Introduction to a Financial Plan

You have studied the marketing, production and administrative plans that should be included in a business plan from the previous chapters. This chapter explains the final and the most important part of a business plan, i.e. the financial plan. The forecasted financial requirements and the profitability of the expected business is included in the financial plan.

Further, the money expected to invest in the business, cash inflows and outflows and the daily cash requirements of the business are estimated by a financial plan. Similarly this shows the expected profit calculated considering the forecasted income and expenditure of the business for a specific period.

**Financial plan is useful for an entrepreneur due to following reasons.**

- To decide the amount of funds required for the business
- To minimize financial problems
- To identify the business result (profit) of the business at the end of a specific period
- To assess the adequacy of the above said business result

Information included in a financial plan are given below.

- Activities and expenses prior to starting the business
- An estimation of the total investment
- Statement of expected cash inflows and out flows
- Calculation of expected business results

Let's briefly discuss each of these parts.

## 5.2 Activities and expenses to prior to business startup

There are activities to be completed and expenses to be incurred before starting any activity. Similarly, before starting a business, certain activities should be done and expenses should be borne by the entrepreneur. Some such activities and expenses are given below.

## Expenses on market survey

One of the main things done before starting a new business is studying the market relating to the business. We call this a market survey. Expenses on market survey includes expenses incurred to gather the required data, to analyze them and to prepare reports relating to the expected business.

### *Examples :-*

Expenses required to study the consumer needs and competitors' methods of products and service distribution price for which the product or the service can be sold

## Expenditure on improving the business premises

The business premises should be arranged to suit the business before starting the business activities. Expenses that should be incurred with this regard are known as expenditure on improving the place.

### *Examples :-*

Installation of electricity, water, internet facility, telephone networks and expenses of land preparation, cleaning and preparing the premises.



*Figure 5.1*

## Expenditure for searching the raw materials and the equipments

Before starting the business, equipments required to the business should be bought and installed. Similarly, if the business is a production, entrepreneur should search for the methods and institutions to get the raw materials and equipments cost-effectively. Cost incurred to find the information relating to the suppliers (institutions) of the raw materials and equipments, their prices, etc. come under this category.

### *Examples :-*

Expenses incurred to visit the suppliers and inspect the materials and equipments, exchange the files and documents, sample inspection

## Registration Expenses

When starting a business it should be registered at authorized institutions. Further, for some businesses, a special approval or licenses should be obtained.

### *Examples :-*

A special license should be obtained from the following institutions when starting a business relating to granite quarrying

Central Environmental Authority -Sri Lanka

Department of Archeology

Geological Survey and Mines Bureau

Expenses incurred to register the business and to obtain licenses come under this category.

## Other Expenses

All other expenses which are not mentioned above and but are to be incurred when starting a business come under this category.

### *Examples :-*

Legal expenses, cost of business plan preparation, expenses for the inauguration ceremony



*Figure 5.2*



### Activity 01

Some of the expenses of newly started “Prathiba” business are given below. If they are pre-startup expenses mark (✓) and if not mark (×) in the given box.

No.	Expense	✓ / ×
01	Paid Rs. 25 000 to ABC company for the market survey	
02	Bought furniture to the office for Rs. 60 000	
03	Paid Rs. 1 500 for the relevant authority council for licenses	
04	Paid Rs. 5 000 to clean the buildings	
05	Cost of preparing the premises to get the electricity supply is Rs. 4 000	
06	Charge to lay cables for the computer network Rs. 8 000	
07	Bought 10 computers for Rs. 800 000	
08	Paid for the preparation of business plan- Rs. 20 000	
09	Expenses for entertainment on the starting day of the business Rs. 8 500	
10	Expenses for exchanging information with the suppliers Rs. 1 000	

## 5.3 An estimation of the total Investment

It is important for an entrepreneur to identify the required investment of the expected business in advance. A total investment estimate is prepared for this purpose. Sometimes this is known as “cost of the project” or project cost.

## **Contents of a total investment estimate**

The total investment estimate of a business plan consists with the following elements.

- ✚ Value of the fixed assets
- ✚ Expenses that should be incurred prior to business startup
- ✚ Initial funds required to conduct the day today business activities (working capital)

### **Value of the fixed assets**

Fixed assets like land, buildings, machineries, equipments, vehicles and furniture are required to conduct business activities. These assets can be utilized for future years in the business. Here all long-term assets and their values that are included in the production, marketing and administrative plans mentioned earlier are considered as fixed assets of the business.

### **Expenses that should be incurred prior to business startup**

We have studied the expenses that should be incurred prior to business startup in the section 5.2 above. All those expenses are taken in to consideration when preparing the total investment estimate.

### **Expenses required to conduct the day today business activities**

Entrepreneur should possess an adequate amount of funds at the beginning of the business in order to conduct the business activities continuously and smoothly. The amount of cash required to conduct the day today business activities are also known as working capital.

When deciding the initial working capital requirement of the business, it is necessary to calculate the production, marketing and administrative expenses that are required from the beginning of the business activities till cash flows in to the business.

Such working capital is estimated based on funds required for all expenses for the above said period including materials, employee salaries, water, telephone, advertising, distribution, rental and interest should be calculated.

It is unfavorable for a business to have an excessive working capital or a deficit and should maintain on an optimum level. If adequate working capital is not within the business, the smooth and continuous flow of business activities will be disrupted.

### ***Examples :-***

If enough cash is not available to buy the raw materials in due time, the business will not be able to do their production. As a result, all the business activities will be stagnated and delayed and business will generate losses.

The risk of maintaining a working capital surplus is the loss of income that can be earned by investing the money in another investment.

Having to pay a higher interest or comply with disadvantageous conditions when getting money instantly for a certain requirement could arise due to a working capital deficit.

After deciding the value of fixed assets, pre-startup costs and working capital requirement, it is necessary to decide whether the business is going to cover those requirements through the owners' investments or funds acquired from external parties.

**Study how a total investment estimate is prepared through the following exercise.**

*Information relating to the business plan prepared for the business "Wardhana Exercise Books" of Mr. Sarath Siriwardene is given below.*

<b><i>Cost estimations</i></b>	<b><i>Rs.</i></b>
<i>Buying a paper cutting machine</i>	<i>150 000</i>
<i>Business registration fee</i>	<i>1 500</i>
<i>Preparing the premises to obtain an electricity supply</i>	<i>25 000</i>
<i>For office furniture</i>	<i>80 000</i>
<i>Buying a computer to the office</i>	<i>65 000</i>
<i>Buying a vehicle for sales and distribution</i>	<i>1 500 000</i>
<i>Buying a fax machine</i>	<i>15 000</i>
<i>Cost of preparing the business plan</i>	<i>22 000</i>
<i>Expenses for the inauguration day ceremony</i>	<i>15 200</i>
<i>Market survey expenses</i>	<i>18 000</i>

*The building which is expected to be used as the production center belongs to Mr. Sarath Siriwardene and its value is Rs. 2 000 000.*

*It has been suggested to get a bank loan of Rs. 1 000 000 to buy the sales vehicle.*

*It is estimated that an amount of cash sufficient for two weeks is required to run the business activities and the amount is estimated to be Rs. 350 000.*

“Wardhana Exercise Books”  
Estimation of total investment

	Proposed investment		Total investment Rs.
	Provided by the owner Rs.	Bank loan Rs.	
<b>Fixed Assets</b>			
Building	2 000 000		2 000 000
Sales vehicle	500 000	1 000 000	1 500 000
Office furniture	80 000	-	80 000
Computer	65 000	-	65 000
Fax machine	15 000	-	15 000
Paper cutting machine	150 000		150 000
<b>A. Total Fixed Assets</b>	<b>2 810 000</b>	<b>1 000 000</b>	<b>3 810 000</b>
<b>Pre-startup Expenses</b>			
Market survey expenses	18 000	-	18 000
Business registration fee	1 500	-	1 500
To obtain the electricity supply	25 000	-	25 000
Preparing the business plan	22 000	-	22 000
Inauguration ceremony	15 200	-	15 200
<b>B. Total pre-startup expenses</b>	<b>81 700</b>	<b>-</b>	<b>81 700</b>
Working capital for business activities	350 000		350 000
<b>C. Total working capital requirement</b>	<b>350 000</b>	<b>-</b>	<b>350 000</b>
<b>Total investment (A+B+C)</b>	<b>3 241 700</b>	<b>1 000 000</b>	<b>4 241 700</b>

Accordingly, Mr. Sarath Siriwardene requires Rs. 4 241 700 as the total investment. Out of that Rs. 1 000 000 will be obtained as a bank loan. Owner's building which is worth Rs. 2 000 000 will be given to the business and Rs. 1 241 700 will be invested from his personal money.



## Activity 02

Some of the information of the proposed garment factory of Mr. Mohommad Iththikar is given below. Based on the information, prepare the total investment plan for "Iththikar Garments".

Item	Cost (Rs.)
To buy 10 sewing machines	400 000
To obtain electricity to the building	25 000
To get the telephone supply	23 000
To buy office equipments	63 000
Market survey expenses	4 500
To buy a cloth cutting machine	200 000
To fix the water supply	11 000
To prepare the business plan	15 000

It is expected to use the building which belongs to Mr. Mohommad as the business premises. The value of the building is Rs. 1 800 000.

Further he intends to provide 05 sewing machines which are already with him to the business. The total value of the machines are Rs. 200 000.

He expects to obtain a bank loan of Rs. 600 000 to buy additional new 5 sewing machines and the cloth cutting machine.

Cash in hand required to conduct the daily business activities should be Rs. 400 000.

## 5.4 Statement of forecasted (budgeted) cash inflows and cash outflows

Statement that is prepared including the proposed cash inflows to and outflows from the business during a specific future period is known as statement of forecasted (budgeted) cash inflows and cash outflows. The amount of cash available within a business at the end of a certain period can be calculated by preparing this statement. This shows the cash inflows to the business and outflows from the business during a specific future period and the cash balance at the end of that specific period.

### Cash inflows

Following are recorded as cash inflows of a business.

- ✚ Capital invested by the owners
- ✚ Obtaining bank loans
- ✚ Receiving cash from cash sales
- ✚ Receiving cash from debtors
- ✚ Income received by hiring buildings or other assets
- ✚ Investment income and interest received by investing the money of the business and any other inflow of cash into the business

### Cash outflows

The cash outflows of a business is determined based on the cost estimations included in the production, marketing, administrative and financial plans of the business. Accordingly few reasons for the outflow of cash from the business are given below.

- ✚ Buying fixed assets
- ✚ Buying inventories of raw materials or merchandise
- ✚ Paying for electricity, telephone, insurance, transportation, rental, and employee salaries
- ✚ Payments for the creditors
- ✚ Paying loan installments and interest
- ✚ Paying taxes

## Cash balance

The difference between the cash inflows and outflows during a specific period or the balance available at the end of the said specific period is known as cash balance.



Figure 5.3

Study how a forecasted cash inflow and outflow statement (forecasted cash flow statement) of a business is prepared for a future year.

### **Examples :-**

Some of the forecasted information for the next year extracted from the business plan of Bhasitha's business who expects to start a stationary shop are given below.

	Rs.
Bhasitha's money invested in the business	1 000 000
Expected sales revenue	3 000 000
Obtaining bank loans	500 000
Paying building rental	120 000
For the electricity bill	12 000
Payment for the creditors	18 000
Paying employee salaries	300 000
Obtaining trade inventories	2 300 000
Paying loan installments and interests	228 200
Buying 08 glass cupboards	300 000
Fixing bookshelves	250 000
Buying office equipment	60 000
Incurring pre-operational expenses	48 000
Receiving cash from debtors	100 000

Basitha's business  
Forecasted cash flow statement for the first year

Description	Rs.	Rs.
<b>Cash inflows</b>		
Owner's investment	1 000 000	
Bank loans	500 000	
Expected sales revenue	3 000 000	
From debtors	100 000	
Total cash inflows		4 600 000
<b>Cash outflows</b>		
Building rental	120 000	
Electricity bill	12 000	
Paying creditors	18 000	
Employee salaries	300 000	
Obtaining trade inventories	2 300 000	
Loan installments and interest payments	228 200	
Buying 08 glass cupboards	300 000	
Fixing bookshelves	250 000	
Buying office equipments	60 000	
Pre-operational expenses	48 000	
Total cash outflows		3 636 200
Cash balance at the end of the period		963 800



### Activity 03

Following are the information extracted from the business plan of Roshitha's business for the following year. Based on the information prepare the forecasted cash flow statement. Show the cash balance at the end of the year.

Description	Rs.
Money invested by the owner	500 000
Bank loan obtained	250 000
Sales revenue	1 860 000
Buying equipments	120 000
Buying tables and chairs	300 000
Expenses for decorating the office	60 000
Cost of business plan preparation	5 000
Buying goods for sale	1 100 000
To pay the electricity bills	20 000
To pay the water bills	25 000
To pay the loan installments	55 000
Business registration fee	1 500

## 5.5 Calculating the business results

By conducting a business an entrepreneur expects to earn profits. If the profit of the business at the end of a specific period is to be identified at present, such expected profit should be forecasted by considering the expected income and expenses.

The forecasted income statement included in the financial plan (a main component of a business plan) fulfills the above requirement of the entrepreneur.

The forecasted income statement includes the following things.

- P Estimated total income
- P Estimated total expenses
- P Expected business result

## Estimated total income

The total value of the products or services sold by a business during a specific period of time is known as estimated sales income. Both the cash sales and the credit sales should be considered here. Similarly, if there are other income a business expects to earn, they should also be included here. Accordingly, the total expected income includes the sales income and other income expected to be earned during the period.

## Estimated total expenses

All the expenses expected to incur for the products and services which are to expected be sold during a specific period of time is known as estimated total expenses. When calculating this expenditure, production cost and non-production cost should be stated separately.

### Production cost

Expenses that directly contribute to the production of the business come under this category. When calculating the production cost following cost should be considered.

- Material cost
- Labour cost
- Other costs (overhead cost)

### Non production expenses

Expenses that do not directly relate to the production activities of the business come under this category. They are;

- Selling and distribution expenses included in the marketing plan
- Administrative expenses included in the administrative plan
- Financial expenses included in the financial plan (e.g. loan interest)

## Expected business result

Expected business result can be calculated by deducting the estimated total expenses from the expected total income. This can be a profit or a loss. The decision to start the business can be made, if the result is a profit and if the investor is satisfied that the profit is adequate for the money invested.



*Figure 5.4*

If the result is a loss, it guides the entrepreneur to make a decision as not to start the business when faced with a loss making situation.

Study how a statement that calculates the final or the end result of business for a future year is prepared.

**Examples :-**

Let's calculate the final or the end result of the below mentioned business - "Sirisara Confectionary" for its first year by using the information available in the business plan.

Item	Value Rs.
Sales income	3 000 000
Raw material cost	1 500 000
Labour cost	300 000
Other production cost	285 000
Selling and distribution expenses	60 000
Administrative expenses	72 000
Financial expenses (loan interest)	24 000

"Sirisara Confectionary"  
Statement of expected end result calculation for the first year

	Rs.	Rs.
Sales income		3 000 000
<b>Less - Total production cost</b>		
Raw material cost	1 500 000	
Labour cost	300 000	
Other production cost	<u>285 000</u>	(2 085 000)
<b>Less - Total non-production cost</b>		
Selling and distribution expenses	60 000	
Administrative expenses	72 000	
Financial expenses	24 000	(156 000)
<b>Net Profit</b>		<b>759 000</b>

Accordingly the entrepreneur of "Sirisara Confectionary" expects to earn a net profit of Rs. 759 000 by the business operations in the first year.



### Activity 04

Amal Fernando expects to start a business which sells ornamental plants. Some of the information extracted from the business plan prepared for his nursery are given below. Based on the information provided, calculate the expected result of Amal Fernando's business.

Item	Rs.
Expected sales income	1 800 000
Raw material cost	320 000
Labour cost	360 000
Other production expenses	220 000
Selling expenses	48 000
Administrative expenses	36 000
Financial expenses	24 000

## Overall business plan

By now you have studied the marketing plan, production plan, administrative plan and financial plan which are the elements of a business plan. Using the data of those plans, a business prepares the overall business plan.

**Study how an overall business plan is prepared according to a simplified format using the description given below.**

### *Udara Leather Products*

*Udara Maduwanthi who lives in Sandhaeliya -Anuradhapura decided to start a business which produces purses unique to each school containing the colors of the school and their badges.*

*She decided to start the production activities targeting the area where she lives at first. The market survey conducted by her revealed that there are approximately 60,000 students in the area and nearly 50% of them are female students. Further it was found that every female student buy at least one purse for a year.*

*Moreover, it was identified that sellers of school items sell different types of purses for competitive prices from Rs. 100-Rs. 200. Sellers have introduced purses which contain stickers of different kinds of pictures to attract the minds of the students.*

*Details of the competitors are as follows.*

<i>Competitor</i>	<i>Product</i>	<i>Market share</i>
<i>Malki school equipments</i>	<i>Purse</i>	<i>60%</i>
<i>Sisira school equipments</i>	<i>Purse</i>	<i>40%</i>

*The estimated raw material cost of a purse is as follows.*

	<i>Rs.</i>
<i>For artificial leather</i>	<i>25</i>
<i>For other components</i>	<i>7</i>
<i>To sew the badges (logos)</i>	<i>20</i>
	<u><i>52</i></u>

*It was decided to recruit a girl with G.C.E. A/L and of 05 years working experience to cut the blocks of leather for the purses and to keep her in the position of foreman. Her monthly salary is Rs. 20 000. She is responsible to supervise the production process.*

*Further it is expected to recruit two female machine operators with G.C.E. O/L and 06 months working experience for a monthly salary of Rs. 15 000.*

*Getting orders, marketing and management activities are planned to be done by Udara herself. She expects to get a monthly salary of Rs. 25 000 for that.*

*Other expected monthly expenses are as follows.*

	Rs.
<i>Factory electricity</i>	<i>2 500</i>
<i>Telephone charges</i>	<i>1 200</i>
<i>Transportation expenses</i>	<i>5 000</i>

*A three wheeler should be bought for Rs. 360 000 to bring the raw materials and to deliver the products. The expected life time of the three wheeler is ten years. Two sewing machines will be bought for Rs. 60 000 each to sew the purses and their useful life is estimated to be 05 years.*

*It is proposed to use her own building which worth Rs. 1 000 000 as the production Centre. A loan of Rs. 500 000 is expected to be obtained from the Entrepreneurship Development Bank under 10% annual interest and the repayment period is 05 years. The loan installment for the first year is Rs. 120 000.*

*Following expenses are expected to be incurred before the business start-up.*

	Rs.
<i>Registration fee</i>	<i>1 200</i>
<i>For electricity</i>	<i>7 000</i>
<i>Inauguration day expenses</i>	<i>5 000</i>

*Working capital requirement is estimated as Rs. 75 000.*

*Products will be available for sale at school sales shops and a purse is given to a shop for Rs. 170. It is expected to sell the purses to 50% of the students with in the first year.*

# Business Plan

## 1. Executive Summary

- 1.1 Business name and Industry :-
- 1.2 Most important points of the marketing plan :-
- 1.3 Most important points of the production plan :-
- 1.4 Most important points of the administrative plan :-
- 1.5 Most important points of the financial plan :-
- 1.6 Specialty or the uniqueness of the business :-
- 1.7 Goals and objectives of preparing and presenting the business plan :-

## 2. Marketing Plan

- 2.1 The product
- 2.2 Target buyers
- 2.3 Target market area
- 2.4 Market relating to the expected product

Product	Number of target consumers	Consumption pattern	Monthly demand		Annual demand	
			Quantity	Value Rs.	Quantity	Value Rs.

## 2.5 Supply analysis of the competitors

Main competitors	Products and services supplied	Approximate market share of the competitors

## 2.6 Target market share

Product or service	Existing market share	Planned market share

## 2.7 Marketing strategies of the competitors

Marketing mix	Strategies
Product	
Price	
Place	
Promotion	

## 2.8 Proposed marketing strategies of the entrepreneur

Marketing mix	Strategies
Product	
Price	
Place	
Promotion	

## 2.9 Forecasted annual sales

Product	Expected monthly sales (quantity)	Unit price Rs.	Average monthly sales value Rs.	Annual sales value Rs.

## 2.10 Marketing expenses

Item	Average monthly selling expenses Rs.	Annual selling expenses Rs.

## 2.11 Marketing Fixed assets

Item	Value Rs	Annual depreciation Rs.
		1st year

### 03. Production plan

#### 3.1 Calculation of total production cost

Item	Monthly requirement	Unit price Rs.	Total expenditure Rs.
Total production expenditure			
Unit cost			

#### 3.2 Production Fixed assets

Item	Value Rs.	Annual depreciation Rs.
		1st year

### 04. Administrative plan

#### 4.1 Details of the entrepreneurs

Name of the entrepreneur :- .....

Address :- .....

Qualifications :- .....

#### 4.2 Organizational structure

Main positions and responsibilities of the organizational structure

Position	Function	Responsibilities	Qualifications

### 4.3 Administrative expenses

Item	Expenses (monthly) Rs.	Expenses (Annual) Rs.

### 4.4 Administrative Fixed assets

Item	Value (Rs)	Annual depreciation Rs.
		1st year

## 05. Financial plan

### 5.1 Pre–startup activities and cost

Pre–startup activities	Expenses Rs.

### 5.2 Total Investment Estimate

	Proposed investment		Total Investment Rs.
	Provided by the owner Rs.	Bank loans Rs.	
Fixed Assets			
Total fixed assets (A)			
Pre-startup cost			
Total pre-startup cost (B)			
Working capital			
Total working capital requirement (C)			
Total investment (A+B+C)			

### 5.3 Estimated (budgeted) cash flow statement

	Rs.	Rs.
Cash inflows		
Less - Cash out flows		
Cash balance at the end of the period		

### 5.4 Statement of expected result calculation

	Rs.	Rs.
Sales income		
Less – Total production cost		
Less - Total non- production cost		
Net profit		

## Let's Answer

01. What is a financial plan?
02. Give examples for pre-startup expenses.
03. State the items that are included in an investment estimate.
04. Provide some examples for cash inflows and cash outflows of the business?
05. Provide some examples that are included in an estimated cash flow statement?

