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UA62/3 April Newsletter

Kentucky Small Business Development Center

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Dear adam,

Business plan financials are one of the most important pieces to the business plan and quite frankly where many run out of gas. Please read below for details on this section.

Also, this Thursday at noon we will be holding an eMyth Study Group Workshop in Garrett Conference Center, room 100. Eight out of 10 small businesses fail within the first 5 years while 75% of franchises succeed. Find out what you can do about it in your small business.

Pick up your copy of the eMyth Revisited by Michael Gerber at a local book retailer and read in order to be prepared.

Sign up [here](#), details are in the right-hand side-bar.

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Business Plan Financials

The Fun at the End of the Plan



In This Issue

[Business Plan Financials](#)



Cash Flow Day

Get Rich on Your Lunch Break

Join us at noon on Thursday, on the hill, (Garrett Conference Center Room 122)

Funding and financials go hand-in-hand. The financials tell you how much you need for funding, and the funding relates back to how much profit there is in the financials.



You need to tie the financials back to the text in your narrative.

Investors like having the track record of an existing business to compare with the projections for the new business. So, it pays to inject real world numbers of comparables when possible.

Your business and marketing sections should provide the assumptions for your financials. Although it is a good measure to have an assumptions subsection as well.

If you're developing financials for an existing business you will be utilizing actual spending and revenues to forecast financials. On the other hand if the financials are for a start up business you're going to be extrapolating numbers but they still need to be based on real data. These numbers need to be backed up by research and or expertise which needs to be highlighted in the plan.

Do not sugarcoat your numbers or present blue sky in this section. Your investors will see right through that and when your numbers lose credibility the whole plan falls apart. If your investors and/or bankers can't trust your numbers they won't trust you.

The opening of your financials section should be a one-page overview of the financial data. If you're preparing your plan for the purposes of attracting funding, you will need to know how much to ask for and what you're willing to give in return - interest, ownership, and the like.

Relevant Financials to Include

Existing Businesses:

- Uses of Funds
- Cash Flow Statement (3 - 5 years)
- Income Statement (3 - 5 years)
- Income Projections
- Breakeven Analysis
- Balance Sheet
- Business Financial History or Loan Application

New Businesses:

- Uses of Funds
- Cash Flow Statement (3 - 5 years)
- Income Statement (3 - 5 years)
- Income Projections
- Breakeven Analysis
- Loan Application

for the eMyth Study Group.

This workshop will teach you:

The Definition of the eMyth

The Three Small Business Personalities

How to Systematize Your Business

The following week, join us for the eMyth Study Group 2, followed by Franchising and Small Business Ratio Analysis - same time, day and place. Click

[here](#) for workshop info.

Parking passes will be provided - pick them up at Garrett room 121 10 minutes before-hand.

Click [here](#) for directions and details.



Quick Links

[Contact Us!](#)

[Register for a Workshop](#)

It may also be useful to include a startup budget for a new business. This will help get an accurate picture of what you'll need in order to get your business up and running.

The Importance of Forecasts

Bankers and investors will be looking at your plan to see the business is a good risk. The income projection is way for bankers and/or investors to get an idea of what the near future-usually three years-all in terms of income and expenses based on reasonable assumptions of costs and sales. Your assumptions should be based on prior experience in real world numbers. Don't try to predict the future with a cracked crystal ball. Be realistic.

Obviously a three-year income projection is a pro forma statement and must be backed up by sound reasoning and expertise-both of which you should have after all your research on industry standards and trends. If you're doing projections based on historic data, make sure to take into account changes in the industry, the economy, marketing, competition, efficiency, cost, etc.

3 to 5 years is the standard for projections.

Forecasting

Your forecasts should be based on realistic expectations and real-world experience. You can also talk to others or even hire professionals to help you get the numbers right. If you're an owner of an existing business, trying including your managers and department heads in planning. This is called bottom-up forecasting.

Bottom-up forecasting uses the knowledge of the front lines to predict as accurately as possible the future needs of your business. Managers and department heads can plan ahead for the needs of their teams and give the data to you to approve and compile. The frontliners know what equipment will need to be replaced next year, what positions will need to be added, and how many training programs need to be added. Your sales team set up to get ideas to where cells are gone what trends might change the path we are currently on. Each manager or department head can look at the next two years month by month and come up with a realistic forecast.

Top-down forecasting is planning for the future with the end in mind. It starts with your goals for three years out and backtracks the steps it will take to get there. Start with the big picture-the industry-and your goals within it. With your market share goal, you can figure out your projected revenue. From there, you work your way down the table, filling in exact numbers where you can and making your best predictions when you can't. Still these are not guesses. Even the advertising section can be worked out logically. You know where you stand with the competition in the industry norms. So you know if you will need to spend more or less than the norm in order to increase your piece of the pie.

Top-down forecasting allows you to work your goals and your company's expectations of the future.

Resources

www.kusbdc.com

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SBA

IRS



Funded in part through a cooperative agreement with the U.S. Small Business Administration.

All opinions, conclusions, or recommendations are those of the author(s) and do not necessarily reflect the views of SBA.

Reasonable accommodations for persons with disabilities will be made if requested at least two weeks in advance. Contact Adam Brownlee, 1906 College Heights Blvd., #61086, Bowling Green, KY 42101. 1-270-745-1905.



Cash Flow Day

Get Rich on Your

Also for new businesses there are five methods to determine the demand for your new business start.

1) Marketing Surveys - asking your potential market how much and how often they will frequent your business.

2) Reverse Engineering - this method involves figuring out your costs and working it back up to the top line and then asking yourself can I achieve this sales level. This method goes hand-in-hand with capacity. If you have 100 seats in a new restaurant can you fill those 100 seats every day and how much revenue does this lead to?

3) A trial run-setting up a small shop either on the Internet or at a flea market and seeing if there is actual demand in a small trial run.

4) Taking a friendly non-competitor out to lunch.

5) Examining similar, public companies and then extrapolating their numbers out to your numbers. For example, you are a retail clothing shop. You can look at public numbers of retail clothing stores and then use a factor to divide down the inflated national numbers to more realistic local number or your store.

The Financial Statements

The Income Statement

Also known as a profit and loss statement, the income statement reveals your business profitability at a set point in time. It assembly income minus expenses equals what is left over. Preparation of an income statement is best on a monthly basis as well as yearly.

Income

Net sales - account for returns, allowances, and markdowns
Minus Cost of Sales
Equals Gross Profit

Expenses

Variable - such as advertising, professional fees, freight, supplies, payroll, repair and maintenance, travel

Fixed - such as Renton, leases, utilities, when repayment and interest, insurance depreciation, taxes and licenses, and office salaries

Total

Income from Operations (Expenses subtracted from Gross Profit)
Other Income - such as interest income
Other Expenses
Net Profit or Loss Before Taxes
Taxes - such as sales, real estate, income, inventory and excise

Net Profit or Loss After Income Taxes

The income statement can help you track the effectiveness of your plans by showing how expenses themselves are affecting profits or losses. It will also help you plan for variations in cells want month-to-month. Though you only

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need one-years worth of info for the business plan, a comparison of income statements over the years can help you see longer-term trends and therefore can help you plan accordingly.

The Cash Flow Statement

The main points about a cash flow statement:

It is fairly similar to the income statement except it reports on a cash basis: it recognizes when cash comes in and when he goes out. For example on accounts receivable and accounts payable, the cash flow statement records the month that the cash was actually paid and/or received. For example if you have a \$100 accounts payable in January the income statement will record \$100 for January but if it is on a 60 day payable the cash flow statement will actually show it in March. The same holds true for accounts receivable. It is on a cash basis. The cash flow statement wants to know when the cash is actually flowing.

The cash flow statement will also report your beginning cash balance as well as your ending cash balance. For example if you start the month with \$1000 in cash, this will be recorded at the top of the cash flow statement. You then go through all your sources and uses of funds, and in the remaining cash is reported. For example if you start with \$1000 you add \$200, and you spend \$500, your ending cash balance will be \$700. This amount is then entered at the top of the next months cash flow statement.

One other difference is that the cash flow statement will capture both the principal and interest payment of a long-term debt whereas the income statement only records the interest payment. The cash flow statement will not record depreciation. Again it is concerned with the cash only.

Balance Sheets

The balance sheet is simply what you own-assets, what you owe-liabilities, and the difference between the two or your equity.

It's important to keep in mind for our context how the balance sheet interacts with your income statement. We want to buy cash flow and assets that will deliver income into our income column on a monthly basis.

The balance sheet over time can be thought of as a moving picture. It shows if the company is reducing debt and building up equity or if it is on a downward spiral.

Assets

Current - assets that can be converted to cash within a year, such as cash, checking and savings accounts, accounts receivable, short-term investments, prepaid expenses and inventory for raw materials to finished products.

Long-term - investments such as stocks, bonds, and special savings accounts to be kept for at least a year.

Fixed - resources not meant for resale-such as land buildings

improvements, equipment, vehicles and furniture.

Other - assorted assets that typically are unique to businesses circumstances.

Liabilities

Current - payable with one operating cycle-such as notes, taxes, interest, payroll accrual, accounts payable

Long-term - mortgages, vehicles, notes and the like-take the current payment due subtracted from the remaining balance

Net Worth or Owner Equity -

Corporations use the total invested by owners or stockholders added to retained earnings after dividends are paid. Partnerships, LLC's and so proprietorships use the original investment of owners added to earnings after withdrawals.

Balance sheets should be prepared on a regular basis not just when you're preparing a business plan. The balance sheet can help you spot trends and plug cash leaks before they sink your company.

Breakeven Analysis

A breakeven analysis answers the question of how much your business will need to sell in order to cover its costs.

For example, if you sell copy machines, the breakeven analysis enables you to figure out exactly how many copiers you need to sell in order to pay all the bills.

The breakeven point is the point when you start to think maybe going into business for yourself was a good decision. It is the beginning of stability. It is a point which many businesses never reach. But numerically, it is the point at which your fixed and variable costs are met by your product and/or service sales. You won't be making a profit but you will no longer be making a loss either.

You can display this point in a number of ways in your business plan. In either graph or table form, you can show dollars of expense compared to dollars of revenue or even dollars of expense compared to units of production-in either products or services.

You can simply show this in the breakeven mathematical formula which is:

$$BE = FC / 1 - (VC/S)$$

You can develop a chart format by showing different levels of sales and how close you are to the breakeven point. For example if you have a business that breaks even at \$24,000 you can show a month at \$24,000 and enter zero for the net. For our example this chart reflects a seven-month period, so in month one for example you might have \$20,000 in sales and a negative \$2000 net and month 2 you might have \$22 000 in sales with a

negative \$1,000 in net.

In the subsequent months you might start showing a profit, say for instance in month four you have \$26,000 in sales with a \$2,000 net profit. Continuing forward you might see \$32,000 in sales for months seven with a \$5,000 in net profit. This can also be represented graphically in the chart with costs on the vertical y-axis and sales over time on them were zonal x-axis. Your fixed costs of course will be a constant level across the graph while your variable costs will be adding increasing level. Your breakeven point would be the point where cells cross your fixed costs plus your variable costs.

Ratios

Potential investors begin the task of analyzing your business for risk and feasibility, they bring experience and expertise to bear in your business plan. What it comes down to is whether or not they think your business proposal, as presented in your business plan, is feasible. In other words, can your business make money?

Ratio analysis involves taking numbers from the financial tables. Knowledge of ratios on your part is akin to learning to speak the language of potential investors. It also gives you valuable management tool. By tracking your ratios, you can spot trends, strengths, weaknesses, and potential roadblocks.

Liquidity Ratios

The current ratio and the quick ratio are two examples of liquidity ratios. The current ratio is used to determine liquidity of existing business by dividing current assets by current liabilities. If they current ratio is greater than 1.0, then the business has a chance of being able to pay short-term bills. The larger the number, the better the chance of paying the bills. If that number is less than 1.0, the business may be in rough water. However, decision-makers will also take into account industry norms. If the industry standard is 4.0, that current ratio of 1.0 is not nearly as good as it would be an industry with an average of say, 1.5

The quick ratio, also called the acid test, is a measurement of liquidity without inventory being calculated. Current assets, not including inventory, divided by current liabilities. Comparing the quick ratio to the current ratio gives decision-makers an idea of how dependent liquidity is upon inventory.

Debt Management Ratios

Debt management ratios include the debt ratio and at times interest earned ratio-tie. The debt ratio is a measure of risk and it shows how well the company's asset supports monetary obligations. The debt ratio is found by dividing total debt, including long-term debt, short-term debt, and current liabilities, by total assets. A high ratio means high risk to potential investors.

The TIE measures how well earnings cover interest and can be found by dividing earnings before interest and taxes by interest. The higher the number the more times earnings can cover interest, thus the safer the investment.

Asset Management Ratios

Inventory turnover and average collection period are both examples of asset management ratios. The inventory turnover ratio measures how often your company gets rid of and restocks an average sized inventory. It is measured by dividing cost of goods sold by inventory. The higher number is better because higher numbers mean you've more quickly gone for your inventory. This means fewer of your business dollars are tied up in inventory. Inventory can cost you in storage, taxes, insurance and interest as well as time. Inventory and time are not friends. As time passes, inventory can become outdated, unpopular, or even unsafe.

Average collection period measures how long it takes to collect on sales on credit. When you sell on credit there will be a lag time. That lag time is measured by the average collection period. It is found by dividing Accounts Receivable by sales and multiplying the total by 360. Obviously, you want the number to be as small as possible. Ideally, you want it as close to your company's terms of sale as you can get it. If the number exceeds your terms of sales significantly-greater than 30%-you show that you are not being as strict with your credit choices as he should be or there is significant customer dissatisfaction.

Profitability ratios

Profitability ratios include return on sales, return on assets and return on equity. The return on sales ratio is the most basic measurement of profitability and says something about how well you can keep down costs and expenses. Divide net income by sales and, voilà you have profitability-at least on paper.

The return on assets ratio similarly says something about how well he you use invested assets is found by dividing net income by total assets.

The return on equity ratio builds on the return on assets by taking leverage into account and is found by dividing net income by equity. Debt affects return on assets and return on equity and the two will be close if debt is small. When debt grows large, return on equity is higher than return on assets when the company is doing well and lower her when the company is doing poorly.

Uses of Funds

Most institutions and individuals want to know exactly what you plan on doing with their money. The best place to start with how you will use the funds you are requesting is to provide a summary of your businesses financial needs. This is the uses of funds section.

This summary is a simple statement of how the funds will be used and includes one-time capital expenses, one time working capital needs, and the first six months of your operating expenses or six months of working capital. The second part of this statement will include the sources of your funds and will include how much the owner is contributing and how much the bank is contributing and or investors.

Assumptions

The purpose of the assumptions section is to explain to readers how you chose your numbers. Readers turn to this section in order to interpret the biases of the preparer. Assumptions answer the all-important question why? Why did you do so for example you could double your sales in two years? If readers don't know your reasoning, they cannot make an educated decision as to the validity of your numbers. Your assumptions are yet another chance to convince your readers. With your assumptions in mind, others within your company are better able to meet goals because they know what is behind those goals.

Don't get lazy with this subsection and never assume that any of the numbers are self-explanatory. Discussions about your plan may occur months after you have prepared your numbers, and you might actually forget why, for example you thought you could double sales within two years.

Thanks,
Adam

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Thanks for taking the time to read our newsletter and for passing it along to folks who might be interested in its content and our services. Please contact us at wkusmallbiz.com if you are starting a small business or if you need a tune-up.

We look forward to serving you.

Sincerely,

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Director, WKU SBDC

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wkusmallbiz.com

**Save
100%**

Our one-on-one coaching is free, always.* If you would like to discuss the above topics, develop a business plan, franchise prototype manual, financial projections or web site or attend one of our workshops, go to wkusmallbiz.com, click on "Contact Us," enter your information and a special little message that preferably comments on how cool we are.

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We have coffee, and if there is any left, we will offer you a cup.

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