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The CPD Fest 2020

Post Pandemic… How to Prepare and Present a Business Recovery Plan

Presenter:

Cormac Lucey – Finance Lecturer & Economics Columnist

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Post-pandemic business planning

- Pre-pandemic business planning
- The pandemic
- Post-pandemic business planning

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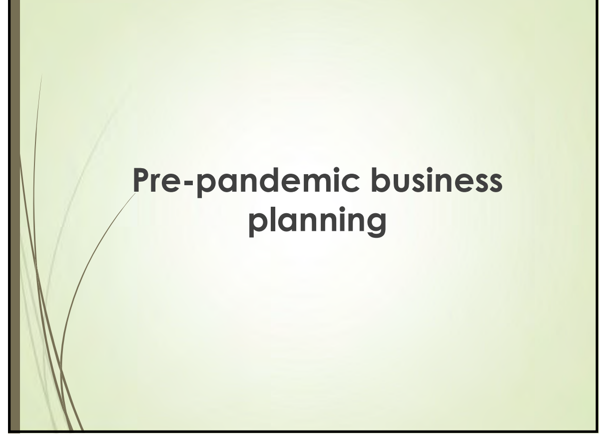

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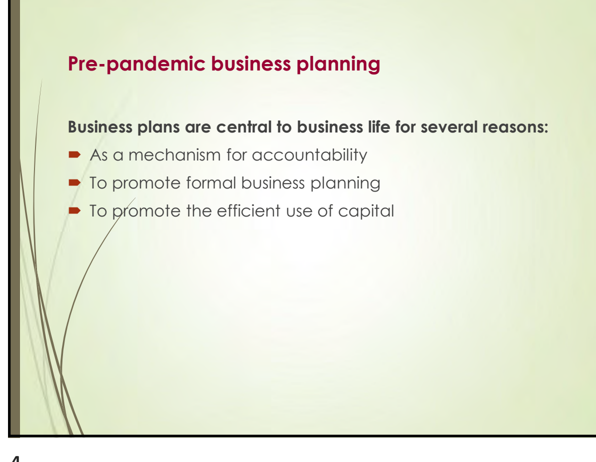

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Pre-pandemic business planning

How value is created / destroyed

- ROIC (return on invested capital) is the key measure of financial performance of a business

  = EBIT X (1-t) / (Debt + Equity)
- ROIC is the after-tax equivalent of ROCE
- By using an after-tax measure of return, we can compare it directly to WACC, weighted average cost of capital, which is also an after-tax measure

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Pre-pandemic business planning

How value is created / destroyed

- ROIC (return on invested capital) is the key measure of financial performance of a business

  = EBIT X (1-t) / (Debt + Equity)
- Capital employed = Debt + Equity = Net operating assets

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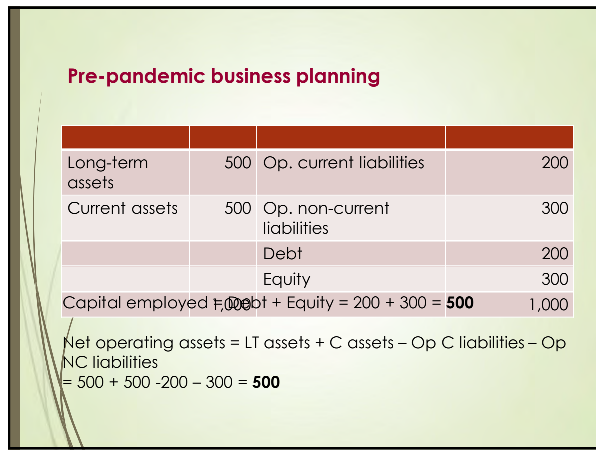

Long-term assets	500	Op. current liabilities	200
Current assets	500	Op. non-current liabilities	300
		Debt	200
		Equity	300
	1,000		1,000

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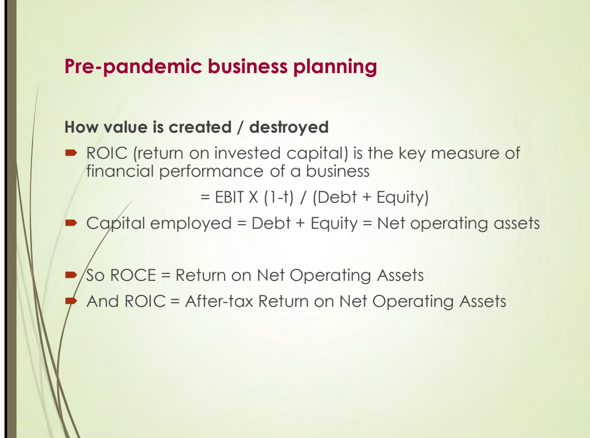

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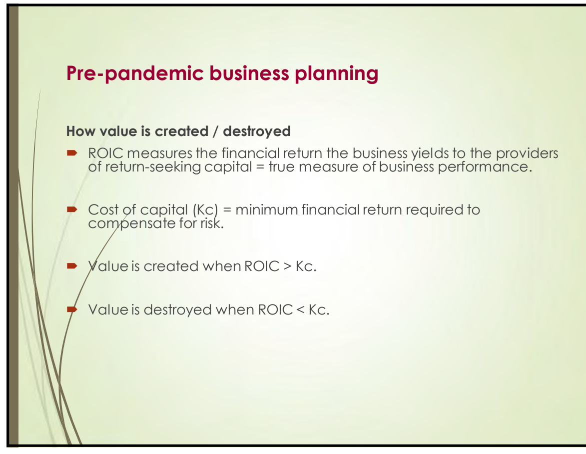

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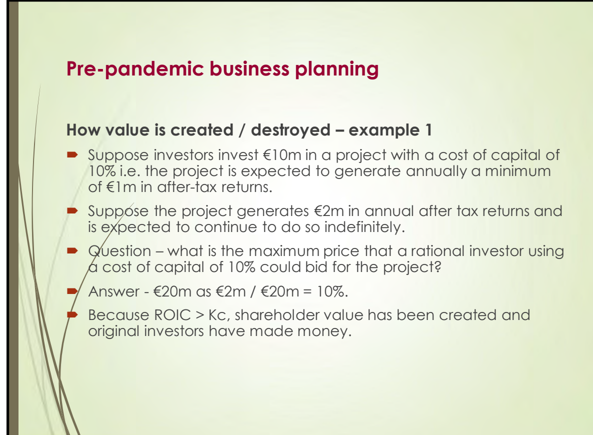

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Pre-pandemic business planning

How value is created / destroyed – example 2

- Suppose investors invest €10m in a project with a cost of capital of 10% i.e. the project is expected to generate annually a minimum of €1m in after-tax returns.
- Suppose the project generates €0.5m in annual after tax returns and is expected to continue to do so indefinitely.
- Question – what is the maximum price that a rational investor using a cost of capital of 10% could bid for the project?
- Answer - €5m as €0.5m / €5m = 10%.
- Because ROIC < Kc, shareholder value has been destroyed and original investors have lost money.

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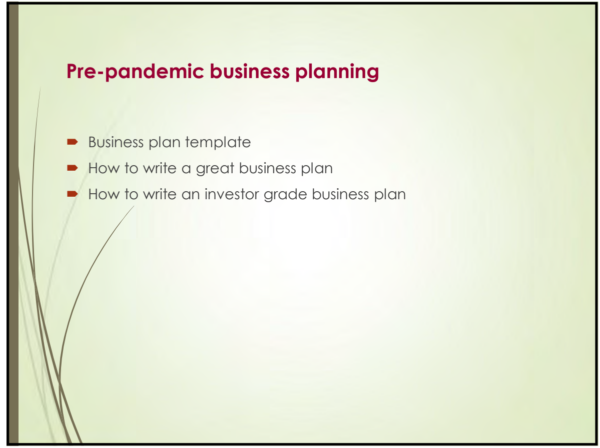

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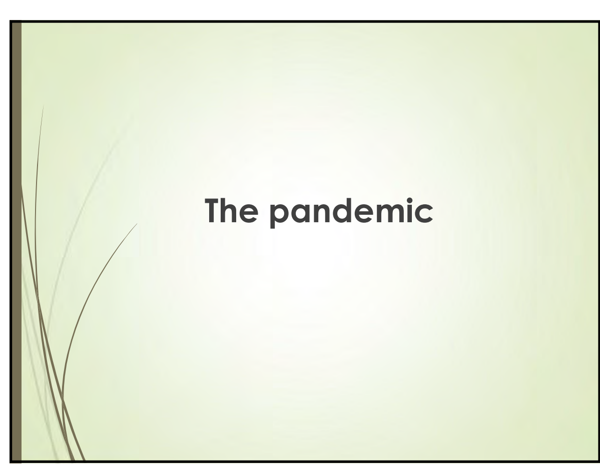

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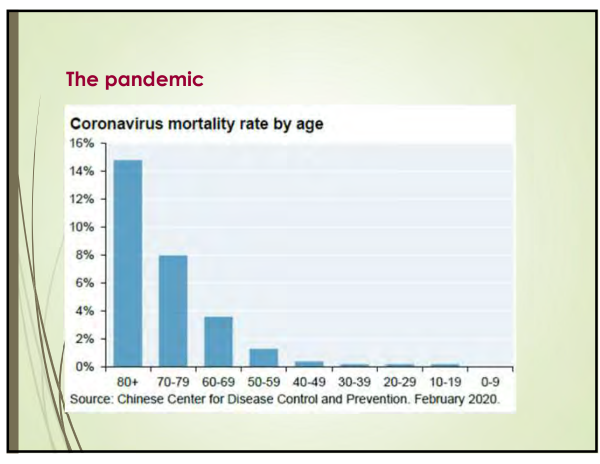

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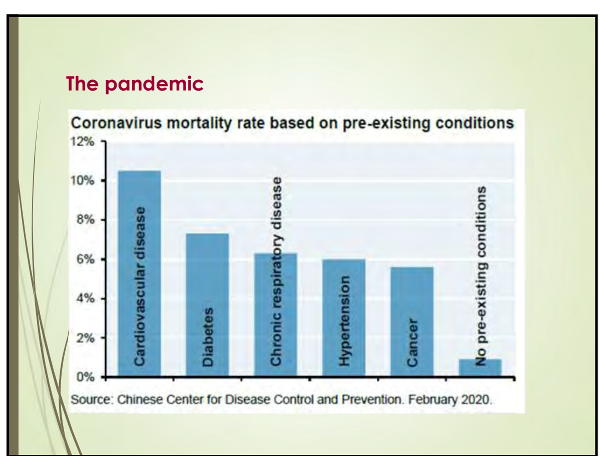

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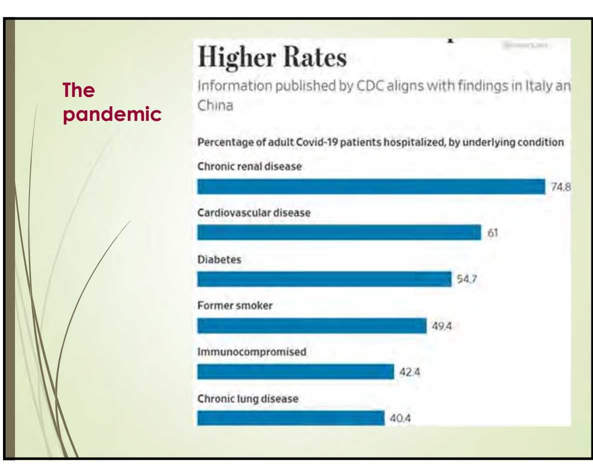

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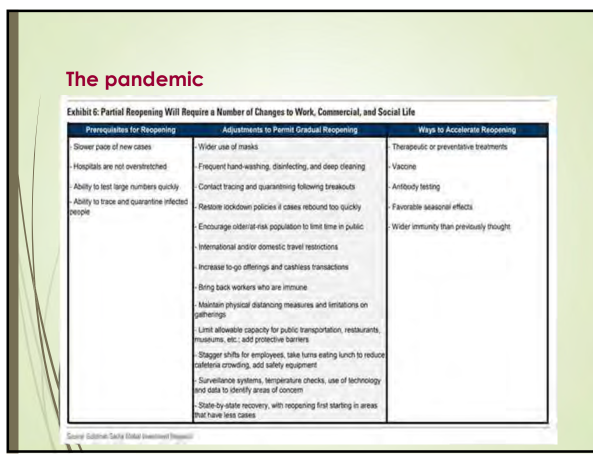

The pandemic

Exhibit 6: Partial Reopening Will Require a Number of Changes to Work, Commercial, and Social Life

Prerequisites for Reopening	Adjustments to Permit Gradual Reopening	Ways to Accelerate Reopening
- Slower pace of new cases	- Wider use of masks	- Therapeutic or preventative treatments
- Hospitals are not overstretched	- Frequent hand-washing, disinfecting, and deep cleaning	- Vaccine
- Ability to test large numbers quickly	- Contact tracing and quarantining following breakouts	- Antibody testing
- Ability to trace and quarantine infected people	- Restore lockdown policies if cases rebound too quickly	- Favorable seasonal effects
	- Encourage older/at-risk population to limit time in public	- Wider immunity than previously thought
	- International and/or domestic travel restrictions	
	- Increase to-go offerings and cashless transactions	
	- Bring back workers who are immune	
	- Maintain physical distancing measures and limitations on gatherings	
	- Limit allowable capacity for public transportation, restaurants, museums, etc.; add protective barriers	
	- Stagger shifts for employees, take turns eating lunch to reduce cafeteria crowding, add safety equipment	
	- Surveillance systems, temperature checks, use of technology and data to identify areas of concern	
	- State-by-state recovery, with reopening first starting in areas that have less cases	

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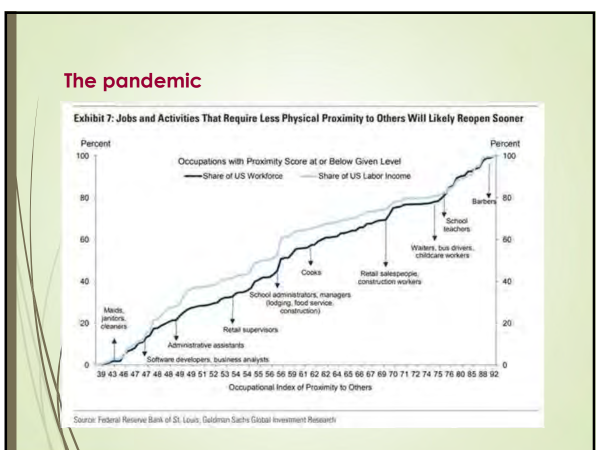

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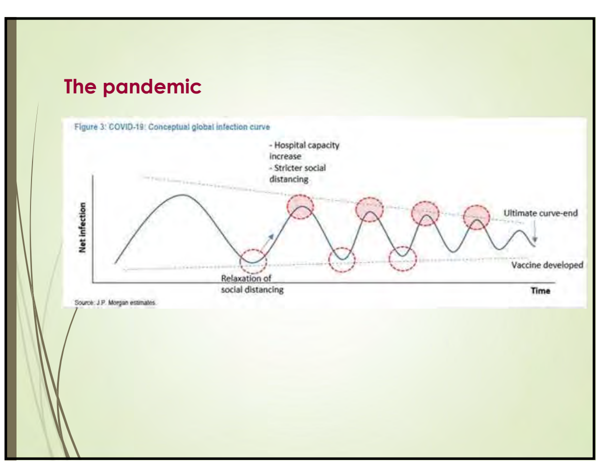

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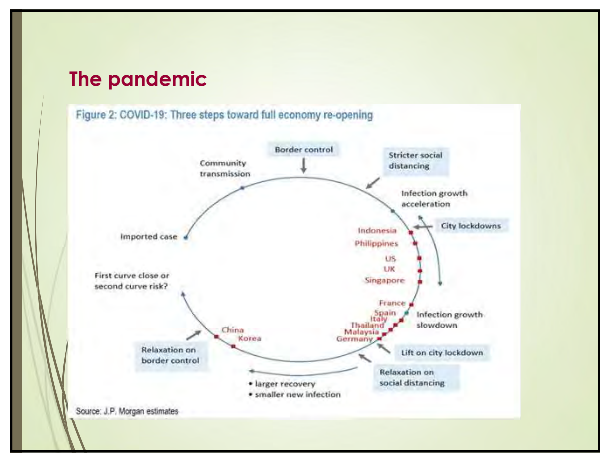

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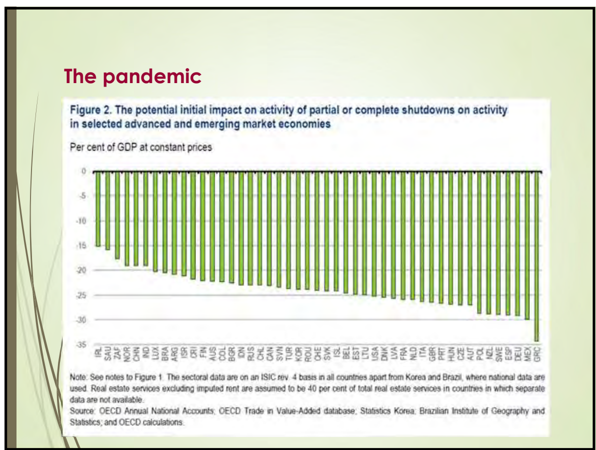

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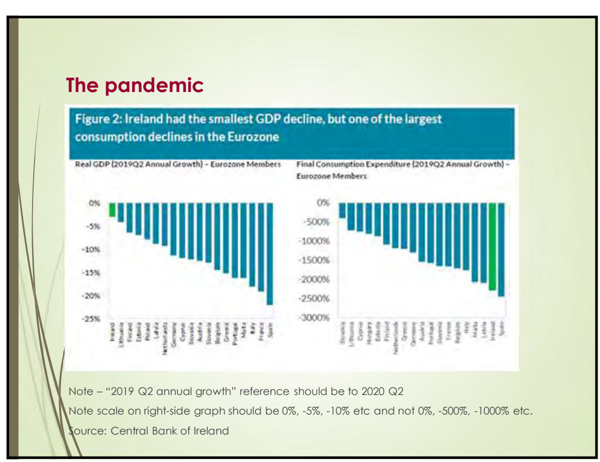

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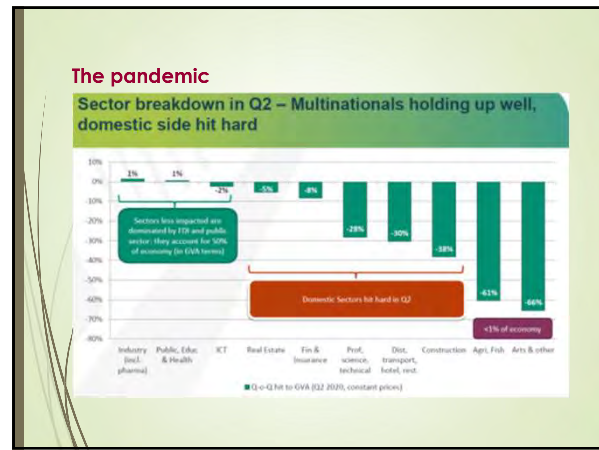

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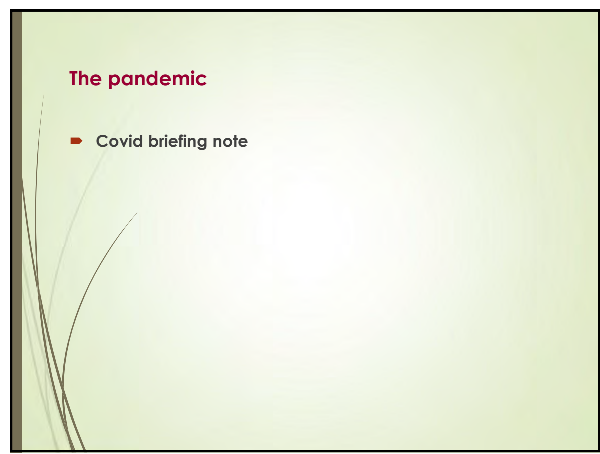

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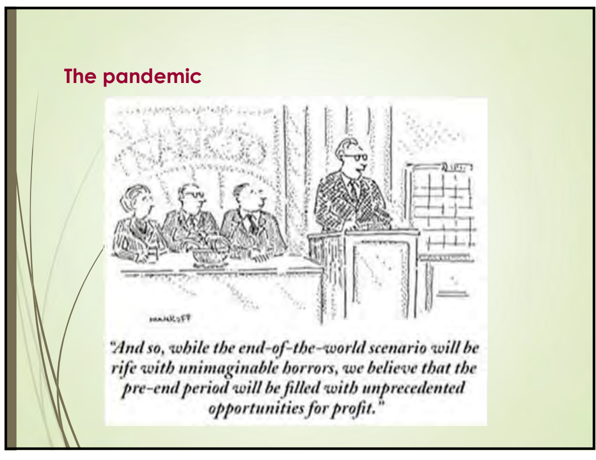

"And so, while the end-of-the-world scenario will be rife with unimaginable horrors, we believe that the pre-end period will be filled with unprecedented opportunities for profit."

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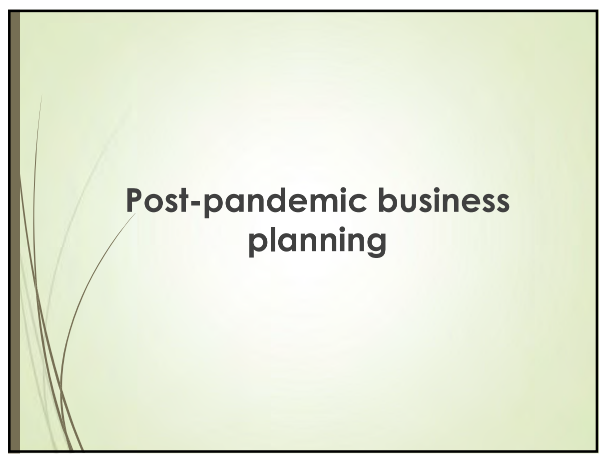

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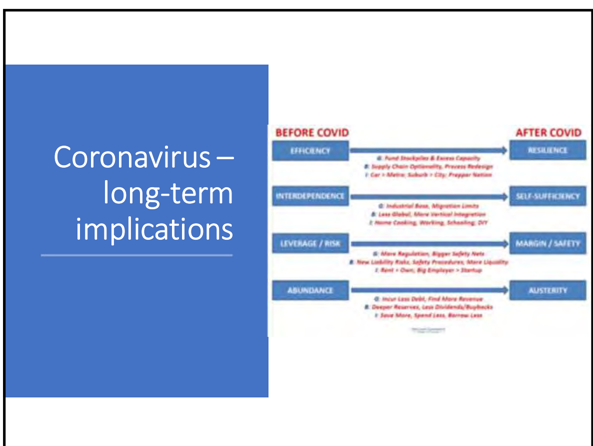

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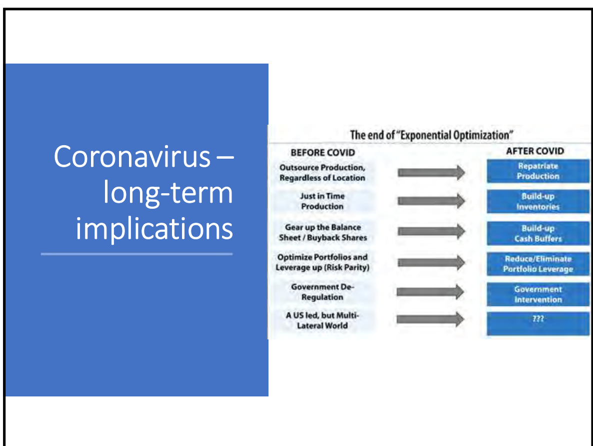

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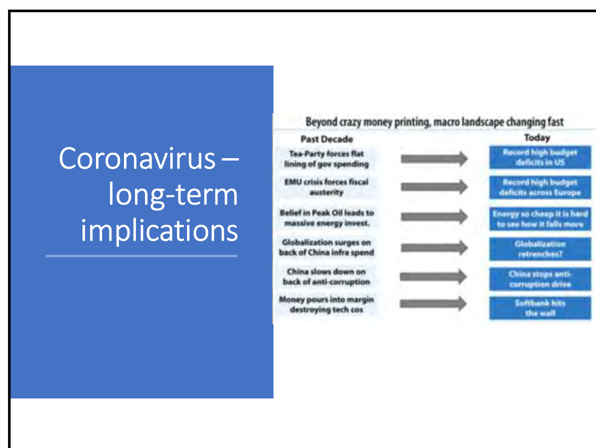

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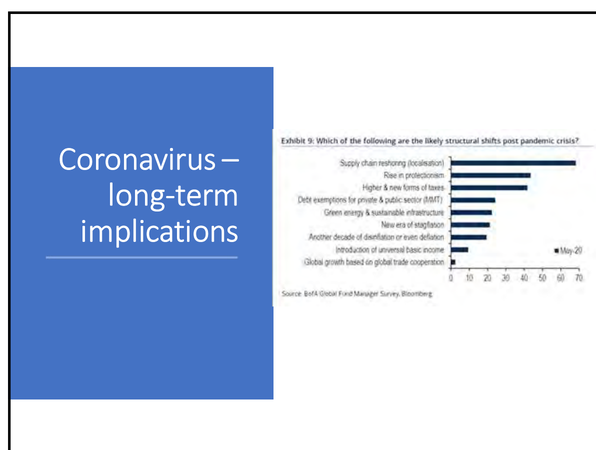

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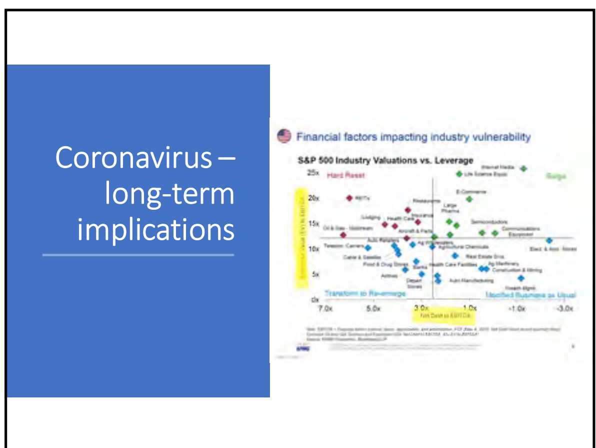

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Post-pandemic business planning

The CFO's role in helping companies navigate the coronavirus crisis

- Launch a cash war room
- Develop scenarios
- Institute a communications plan
- Bolster productivity
- Re-evaluate investments and strengthen the balance sheet
- Turbocharge the role of financial planning and analysis
- Adopt a transformation mindset when reallocating resources
- Consider how M&A and divestitures could improve the portfolio
- Boost productivity through digitization

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Post-pandemic business planning

Planning for uncertainty: Performance management under COVID-19

- Get a clear view of the company's starting position
- Develop a range of scenarios
- Establish the 'direction of travel'
- Determine best actions and moves
- Identify 'trigger points'
- Institutionalize new ways of working

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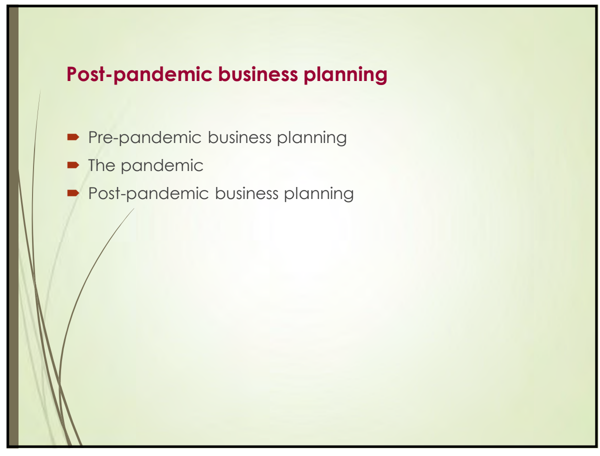

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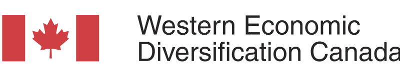
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Business Planning and Financial Forecasting

A Start-up Guide

Western Economic Diversification Canada and the
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The Business Plan

Introduction

You want to start a business – or expand your existing business. You have a great idea, super attitude and the entrepreneurial spirit. So you head down to your local bank or financial institution; you sit down in front of the credit manager and start to explain this brilliant idea when she interrupts you: *"That sounds great, but where is your business plan?"*

This scenario is played out every day in Canada – people with ideas who want to plunge into business without having done a business plan. The purpose of this guide is to explain in simple terms the business plan concept and to show you how to put your own plan together.

A Start-Up Guide leads entrepreneurs through the business planning process. By describing everything from Vision and Mission to Operational Strategies, the Guide provides an easy to read description of your new business concept. The affiliated "Financial Planning Template" helps entrepreneurs assemble their Starting Balance Sheet, Pro-Forma Income Statement and first year Cash Flow Forecast. This MS Excel template is available at http://www.cse.gov.bc.ca/ReportsPublications/FinancialTemplate.XLT. There is plenty of help available to you including courses from your local college or school board and of course the services and information resources of Small Business BC, including the *Interactive Business Planner* located at www.smallbusinessbc.ca/ibp.

Why do a Business Plan?

Your own thinking process is solidified through the planning process.

The planning outline provided in this guide leads you through a series of questions and issues that you should consider when thinking about your business. *Remember that you are an investor in your own business.* You are the first person who must have confidence in the validity of your business concept.

Your bank or financial institution will need to be convinced of the viability of your business, or your business expansion.

The business plan is a *communications tool* to inform and influence the reader towards some action – providing a loan, extending credit or investing in your business.

Your business plan provides some guideposts in running your business.

You will set goals and then, once you are in business, you can measure those goals against the actual performance. Goals should be specific, measurable, achievable, realistic and time limited – *SMART*.

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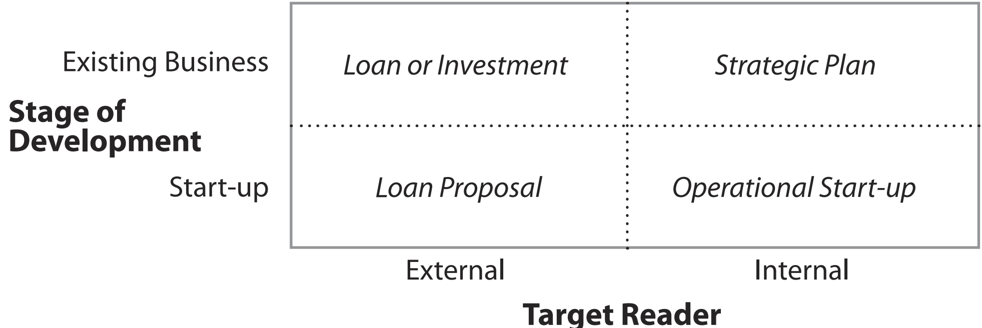
What is in a business plan

There seem to be as many kinds of business plans as there are business planning guides. There are two ways to look at the business plan: by stage of development, and by target reader. Under the stage of development, there are generally two ways to divide the planning style: start-up plans and plans for ongoing businesses. Under the target reader there are also two ways to look at the plan: an inside reader and an outside reader.

Graphically, we can look at it this way:



There are of course many variations on the general categories. (For example, a rapidly growing business requires a slightly different emphasis for both its strategic and loan / investment plan.) Although there are different plans and different readers, there are similarities in each of the four plans – including the financial forecast, which is common to all business plans.

A business plan geared to an *external reader* is written with a specific objective in mind – usually a loan or an investment. Before writing the external plan, you as the business owner must believe in your business. After all, how can you convince a bank or financial institution to lend, or an investor to invest, unless you are personally convinced of the validity of the business?

A business plan geared to the *internal reader* serves two purposes. It is a road map for taking the business in a particular direction. It is also a litmus test for the business. Setting goals and objectives is one thing, but determining the steps needed to accomplish these goals is quite another. The planning process allows the entrepreneur to determine what might or might not work. For example, a business owner may research the idea of opening a chain of stores only to discover that franchising is a more effective way to expand the business. Likewise, in a start-up situation, an entrepreneur may discover during her market research that her hometown is not large enough to provide a sustainable market for her chosen endeavor. She can then consider a different type of business, or start her business in a different location.

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This Guide

This guide to Business Planning and Financial Forecasting is written for the Start-up Business to communicate with an external reader, with special emphasis on banks or financial institutions.

Be clear and inform

You cannot assume that the reader of your plan knows anything beyond what you have stated in the plan. You may know what you mean, but have you clearly explained it to the reader? As you go through this outline, constantly ask yourself if you are making yourself clear to a reader who is not familiar with your industry or your business. *Your business plan may be your only representation to an outside party such as a bank or financial institution!* In most business start-up situations, the lender is basing their decision on the viability of the business and the character of the entrepreneur. Your business plan not only represents your business – it represents you.

Here are a few tips on the actual writing of the plan:

Do's

- Try to keep it fewer than twenty pages, exclusive of the appendix.
- Use bullet points and numbered lists wherever possible.
- Use, but do not overuse, graphs, diagrams and photographs.
- Have a neutral third party read the plan – especially someone unfamiliar with your industry.
- Include a table of contents and page numbers in your plan.

Don'ts

- Avoid big words and long sentences. They only serve to confuse the reader.
- Don't use technical words and unnecessary jargon. If you need to introduce a technical term, then you should define it.
- Avoid using acronyms and initials to express words is another common error. You may be very familiar with the acronym but your reader might not. If an acronym has become as common as a word, such as SCUBA or LASER, then use them. If they are still technical, such as URL then you may need to define the acronym and its meaning.

Outlining your business plan

There are many different outlines you can use for your business plan. The following outline is designed specifically for the reader. A good plan for an outside reader anticipates and answers the readers concerns and important issues. To see a sample plan, go to: www.smallbusinessbc.ca.

Planning Outline

Introduction

- Business Concept
- Plan Goals and Objectives
- Management / Ownership

Products & Services

- Product / Service Mix
- Product / Service Risks

Market Research

- Industry Research
- Customer Research

Marketing Strategies

- Pricing
- Physical Distribution
- Promotion

Operations

- Process
- Procurement
- Personnel (Human Resources)
- Legal and Administrative

Finance

- Breakeven
- Starting Balance Sheet
- Pro-forma Income Statement
- Cash Flow Forecast
- Program and Finance

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Elements of a Business Plan

Purpose: *The purpose of the executive summary is to get the readers attention by summarizing the key elements of the business plan. It must be short, to the point and very well written.*

This is arguably the most important part of the business plan. The *Introduction* must make your reader want to keep reading. It is a good idea to write as much of the *Introduction* as you can at the outset of the planning process. This initial writing will help you to focus your attention on the goals of the plan. You should then *rewrite* the *Introduction* after you have completed the rest of the business plan. This way the specifics of the plan, and the changes made during the planning process are accounted for. You are addressing the issues of what you do, where you are going in the short term and what you want from the reader of the plan. *This section of the plan should be two to three pages long.*

Business Concept

- Describe what your business does in general terms.
- Include your mission or vision statement.
- Describe what differentiates your business from others. This is important to the reader, as they want to know how your business will be able to create new customers. What do you offer that will take customers away from competitors?
- Briefly describe your business history if applicable.
- Provide any other information that will excite the reader about your business.

Goals & Objectives

- Tell the reader what you want (e.g. a business loan for a specific amount to purchase equipment).
- State your sales, production and profit goals. Be specific in amount and time line.
- If this is for a bank loan, comment on goals such as anticipated time to achieve a positive cash flow and the ability to service debt. (Note you cannot complete this section until the rest of the plan is complete.)

Management Ownership

- Briefly describe the technical qualifications of each principal in this enterprise.
- Briefly describe the business qualifications of each principal in this enterprise.
- Tell the reader your business structure (i.e. proprietorship, partnership, and incorporation).
- Provide a fact sheet with contact information such as name, address, telephone, e-mail, etc.

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Products and Services

Purpose: *The purpose of the product/service section is to detail exactly what your business does for the customer and what makes these offerings desirable.*

Product Oriented Businesses

- Describe each product you sell. The combination of products is your product mix.
- If you cannot list each product, break the business down into logical categories.
- Describe the key product features, and how your products are different from those of your competition. (Functionality, durability, ease of use, etc).
- Describe product protection such as patents, copyrights and trademarks.

Service Businesses

- Describe each type of service you offer (be specific).
- Describe the service features in terms important to the customer.
- Describe any service protection such as copyrights or trademarks.

Product Risks

If there are any risks associated with your product or service such as product liability, professional liability, or ease of duplication by competition, state them and describe how you will mitigate these risks.

Market Research

Purpose: *The purpose of the Industry and Market Research section is to prove that the market is large enough in your area to support the survival and growth of your business.*

Industry Research

Describe your industry. If you are in a new industry, or an industry not well known to a reader, this will be a fairly comprehensive section. A better known industry requires less explanation.

- Describe the state of the industry. Is it a new industry, growth industry, competitive industry, or a stable mature industry?
- Document industry trends on a local, national or world scale. Sales, number of customers, number of units sold, trends in related industries are all good industry indicators.
- Describe the key customers for your specific industry.
- Provide other national/international economic indicators that encourage the health of your industry.
- Examine risks to the industry caused by legislation, technological change or any threat to the industry as a whole.

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Target Market - Customer Research

The Target Market is the groupings of consumers or businesses most likely to purchase your products or services. The first group you plan to target is your *Primary Target Market*; the second is your *Secondary Target Market*. It is very important that you understand your target markets – after all, these are the customers you need to keep happy!

	Consumer Markets	**Business Markets**
Who is the customer? (Provide both the description and the information in this section.)	• Age • Gender • Income • Family Status Be sure to include how many customers there are in each grouping.	• Industry Type • Size of Customer • Annual Sales Estimate the number of companies using directories or Yellow Pages.
Where is the customer?	Target the geographic radius of your customer base by city, region province or country.	The geography of business to business markets tends to be larger than consumer markets.
When do they buy?	Is there a particularly busy season for your product or service?	If you are selling to seasonal businesses, the timing can be everything. (e.g. wholesaling)
What do they buy?	• Necessity • Luxury Item • High involvement/Big ticket • Low involvement/consumable	• Inventory Item (e.g. item that is resold) • Capital Item • Consumable Item
Why do they buy?	How does your product or service help the consumer?	How does your product enhance the performance of the customers' business?
How much do they buy?	Determine how much is spent on your product by your customers.	Estimate the commercial expenditure by the industries in your target area.

Note: *If you are using indirect distribution, it may be necessary to describe both your customers as a target market, and the end user as a target market.*

It is a good idea to state your sources. This gives the reader more confidence in the information and in the case you are making for your business.

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Competitive Analysis

- Provide the results of any customer survey work you have done and the sources of information.
- List the direct competitors in your local market. These are firms who offer exactly what you offer. List the current number and the number in existence for the past three-year period.
- List the indirect competitors in your local market. These are firms who offer substitute products.
- Analyze any competitors who have gone out of business in the past and if possible describe why their business failed.
- Explain how your firm will compete with these competitors to prove how you can survive in their markets.
- Examine risks that could occur when you enter the market. For example, what if your key competitor cuts their price when you open your business?
- Position your product. Show how your products/services or company is different from your competition.

Market Strategies

Purpose: *The purpose of the Marketing section is to demonstrate how you plan to tap your market. This includes pricing, distribution, sales and promotional strategies.*

Marketing is one of the most misunderstood aspects of business. To many, marketing is sales and promotion. Sales and promotion are important elements of marketing, but marketing is a broader concept. It envelops the design and packaging of a product – the price and discounting strategies for the business – and the intimate knowledge of the current and future needs and wants of the target market. To create a balanced approach you should research all elements of marketing– not just advertising, sales and promotion. Here are some of the key elements of marketing you want to address in your business plan.

Price Strategy

- What are your prices for different products and services?
- How did you arrive at those prices? (i.e., Charge going rate, industry standard mark-up, etc.)
- Do you have any price packages?
- What is your price image? (i.e., bargain, middle of the road, high end) Is this consistent with your target market?
- How do your prices compare with your competition?
- Have you accounted for markdowns and off price promotions?

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Physical Distribution

Describe which of the following distribution systems you plan to use in your business:

- Direct Distribution – selling directly from producer/provider to the customer.
- Wholesale Distribution – selling to a retailer who sells to the customer.
- Brokers or Agents – using a third party to sell the product – usually on a commission basis. This can be done for goods (Manufacturers' Agents) or for services (Speaker's Bureau).
- Hybrid Distribution – Using more than one of the above.
- Internet Sales – See Internet Strategies Section.

Location

- Neighbourhood Location (use a map). Traffic counts and supporting information such as population radius is helpful. *Remember to include direct and indirect competitors on your map.*
- Site Location – place in a mall, shopping centre, or city block. Show the other tenants and access/egress for parking if applicable.
- Facility Location – including a diagram of the business layout.
- Signage – both inside and outside the business.
- Location risks. For example, a median placed in the middle of your road will cut off access to your business. Check with your city-planning department before signing a lease.

Advertising & Promotion

Your promotional strategy is made up of three main areas. Not all businesses use all three, so only include the parts relevant to your situation. Small Business BC has resource people dedicated to help clients with this aspect of your business.

Advertising Plan (Paid Advertising)

- Provide a list of the media you plan to use. You may include newspapers, magazines, radio, television, direct mail or Internet advertising.
- Develop a monthly advertising schedule with planned budget amounts.
- If you have written any ads or brochures, include them as appendices to the business plan.

Public Relations Plan

- Include media sources you plan to use to promote your business.
- Include press releases in the appendices to the business plan.
- If you are using a Public Relations firm indicate the name of the firm in this section.

Personal Selling Plan

- Describe how you will prospect and find new customers.

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- Describe how you will provide new customers with information.
- If you have letters of agreement, contracts or other sales tools, it is sometimes advisable to include them as appendices to the business plan.

Internet

Canada uses a consumer benefit model known as ICET. You should describe your Internet strategy in the same way with the following:

- Information Gathering – This includes the information provided to the consumer about your business, products and services.
- Communication – This includes more specific forms of two-way communication such as customer service and feedback mechanisms.
- Entertainment – This is the multimedia aspect approach to your site. This includes animation, sound clips and video clips.
- Transactions – This is the ability to actually order and pay for products over the Internet.

Operations

Purpose: *The purpose of the Operations section is to indicate how you plan to operate the business. This means how you will produce the services or provide the products.*

Production Plan (Manufacturing Businesses)

The production plan demonstrates your ability to produce products. This section may not apply to service businesses.

Production Flow Chart (Manufacturing businesses)

- Provide a flow chart/process diagram showing the entire production process from start to finish.
- List and budget production equipment required for the business.

Procurement (Businesses that manufacture or sell products)

- Sources of supply and order lead time.
- Terms and conditions of sale.
- Alternate sources of supply (this addresses procurement risk).
- Inventory control systems.
- Physical space requirements (unless covered in location sections).

Sub Contractors (both goods and services)

- Provide a list of sub-contractors.
- Show exactly what these sub-contractors do and where they fit into the production of the business.
- Show alternative sub-contractors (this addresses sub-contract risk).

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Human Resources

Purpose: *The Human Resources section demonstrates how you will determine your HR needs, fill them, manage your staff and pay them.*

Staffing

- Organizational chart (show reporting structure).
- Job descriptions (show what people do).
- Job specifications (show the skills and knowledge required to do each job).
- Recruiting – Where will you find good people?
- Management – How will you treat those good people?
- Compensation – How much will you pay your people? This includes base wages, commissions, bonuses and other incentives. (Don't forget your statutory benefits of EI, CPP, WCB & Holiday pay, in addition to any benefits you plan to add.)
- Human resources risks. Look at contingent plans for loss of key personnel, labour shortages or strikes.

Professionals & Mentors

- Accountant
- Lawyer
- Bank Services
- Business Advisors and Mentors (it can be helpful to provide single-paragraph biographies on key business advisors.)

Legal & Administrative

- Legal Form (proprietorship, partnership, corporation, cooperative).
- Share Distribution (Corporation Only)
- Directors & Officers (Corporation Only)
- Buy Sell Agreement (Corporation and Partnerships Only)
- List of key legal agreements such as contracts, leases, agreements, franchise agreements, personal loan guarantees etc. The actual documentation is often put into the appendix of the business plan.
- Insurance/Risk management

Financial Plan

Purpose: *To show the financial requirements to start the business, and to keep the business profitable and liquid.*

- Starting Balance Sheet
- Pro-Forma (Forecast) Income Statement
- Cash Flow Forecast
- Notes to the Financial Plan
- Statement of Personal Net Worth (for lending purposes)

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Appendices

Purpose: *The purpose of the appendices is to provide supporting documents for claims made in the business plan. They may not necessarily be read, but are there for reference purposes.*

- Resumé(s) of principals
- Letters of agreement / intent (potential orders, customer commitments, letters of support). This adds a great deal of credibility to the outside reader, including the bank or financial institution.
- Sample ads and brochures
- Collation of market surveys
- Other
- Price lists
- Personal net worth statement (including personal property values, investments, cash, bank loans, charge accounts, mortgages, other liabilities. This will substantiate the value of your personal guarantee if required for security.
- List of inventory (including type, age, value)
- List of leasehold improvements (including description, when made)
- List of fixed assets (including description, age, current market value of any equipment; legal description of any lands; description of any encumbrances on assets to be pledged for business purposes)
- Description of insurance coverage (e.g. insurance policies, amount of coverage)
- Aged accounts receivable summary
- Aged accounts payable summary
- Copies of legal agreements (e.g. contracts, lease, franchise agreement, mortgage, debentures)
- Appraisals (include recent appraisals of assets such as buildings, property, and equipment or provide a market evaluation of the business and an asset list outlining the asset, the year purchased and amount paid)
- Financial statements for associated companies (where appropriate)
- Name of present lending institution (including branch, type of accounts)
- Lawyer's name (include address and phone/fax number)
- Accountant's name (include address and phone/fax number)

Some final thoughts on planning

A famous general once said: *"In preparing for battle, I have found that plans are useless, but planning is indispensable."* Starting a business is a great undertaking. You want to be prepared. So here are some tips to keep in mind while in the planning process:

- Keep an open mind. Don't try to make something work that cannot work, just because you like the idea.

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- Remember the Rule of 2 and 3. It takes twice as much money and three times as long as we anticipate. So plan accordingly.
- Be flexible – while developing the business plan other ideas, markets, products or services may come to mind. Explore them.
- Make your mistakes on paper – it is far cheaper than making them in real life.
- Keep planning! It can be difficult to plan when you are running your business, but it is very useful to re-examine your goals and objectives on a regular basis. Don't ever let the business squeegee out the creative entrepreneur.

Use all available resources to help you develop your plan.

This can include formal and informal mentors, other entrepreneurs or friends who will act as the "devil's advocate." Small Business BC provides a business plan review service, and an *Interactive Business Planner* at www.smallbusinessbc.ca/ibp. Community Futures Development Corporations (CFDCs), throughout rural British Columbia, are another excellent source of business advice. To locate your nearest CFDC go to www.communityfutures.ca/provincial/bc and click on *Locations*.

Are you ready for the lifestyle?

Self-employment is not for everybody! Try one of the many self-assessment guides. Western Economic Diversification Canada offers such a test at http://www.wd.gc.ca/tools/xindex_e.asp. It will at least make you more aware of the entrepreneurial lifestyle and the challenges.

Most of all – be persistent.

Sometimes you will try many variations on a theme. You may have to increase or decrease a product mix – change the way you distribute your product or even change the business.

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2 The Financial Plan

Introduction

The financial plan is critical to the success of your business plan – especially if it is for the purpose of getting a bank loan. The Cash Flow Forecast is arguably the most important part of the plan, but each of the other documents is important from a planning perspective. There are three sections in a financial plan:

- The Starting Balance Sheet
- The Pro-Forma (or Forecast) Income Statement
- The Cash Flow Forecast (each of these sections should have notes of explanation for the reader).

The Financial Planning Template

To assist you in this process, we have created a template written for MS/Excel. Click here to access the template. This will take you through seven worksheets, each asking for financial information. This information is then assembled into the three statements described above. Information can be changed, and the results of the change are immediately calculated. This will take you to a reasonable first draft of your financials – but you will have to make some final adjustments for your particular situation.

If you are using a printout of this guide you can find the Excel template under http://www.cse.gov.bc.ca/ReportsPublications/FinancialTemplate.XLT.

Before You Get Started

The Beauty of "What If?"

It is almost impossible to get things right the first time. In all business planning, but especially in the financial section, it is important to try different scenarios. What if I purchase used equipment instead of new equipment? What if I raise or lower prices? What if I reduce my personal draw? By trying different scenarios, you will soon determine what it will take to make your business financially viable.

With business planning, you must keep trying until you have a result that is reasonable and that you are convinced is achievable.

Five Tips on your Financial Plan

1. **Be persistent!** Most people do not have expertise in finance so preparing a financial plan is a journey into the unknown. Be patient.
2. **Read the entire planning guide** before starting on the plan. You will learn what information you require to assemble the financial part of the plan.
3. **Get help in assembly, but not in research.** These should be your numbers and assumptions. You will be responsible for achieving these objectives so you should believe in the numbers.

Financial Plan Outline

Starting Costs

- Estimate Current Assets
- Estimate Capital Assets
- Estimate Start-up Expenses

Starting Balance Sheet

- Total Assets (from above)
- Planned Investment (Equity)
- Planned Loans (Liabilities)
- Balance Sheet Formula
- Assets = Liabilities + Equity

Income Statement

- Start-up Expenses (from above)
- Forecast Revenue
- Forecast Cost of Goods
- Forecast Overhead Expenses
- Revenue - Expenses = Net Profit

Cash Flow

- Estimate Monthly Sales
- Adjust Monthly Sales for AR
- Account for loans & investments
- Calculate Total Receipts
- Estimate Monthly Purchase
- Adjust for AP
- Estimate Monthly Overheads
- Estimate Loan Repayment
- Forward Start-up Costs
- Calculate Disbursements
- Starting Balance
  + Receipts
  - Disbursement
  = Ending Balance

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4. **Be consistent.** Make sure that your financial plan is consistent with the rest of the business plan. For example, if your pricing section mentions a margin of 40%, this should be reflected in your Income Statement.
5. **Use the simple template provided.** (It is an *Excel* download.) Although it will not provide a final plan, it will get you well on your way in the journey. Go to http://www.cse.gov.bc.ca/ReportsPublications/FinancialTemplate.XLT.

Calculating The Break-even

The break-even point in your business is the point at which your sales revenue equals your total expenses. At that point you neither make money, nor do you lose any. The break-even lets you know what it is going to take in sales just to survive. It provides a good indication of the viability of a business project.

The break-even can also be used to evaluate a business expansion or any other business expenditure. You are simply asking how much additional revenue will be required to cover the additional cost. There are some key definitions necessary to determine the break-even for the business. They are:

Fixed Costs (Overhead) are costs that do not vary directly with sales. Utilities, salaries, advertising, office supplies and telephone are just a few examples. They do not have to be the same every month. What is important is that you pay them regardless of sales made.

Variable Costs (Cost of Goods) are the actual costs of making the product or providing the service. They can include materials, shipping and contract labour.

Capacity governs your output. It can be measured in units of production, billable hours, or sales volume. To calculate the break-even in units we use the following formula:

$$\frac{\textbf{Fixed Costs}}{\textbf{(Unit Price - Unit Cost)}} = \textbf{Break-even in Units}$$

This method is known as *Total Absorption Costing*, because dividing the total cost by the units sold absorbs the fixed costs. Every business plan – be it for growth or for start-up – needs to establish project and business costs *before* proceeding.

Note: *For planning purposes treat the entire term loan payment, both principal and interest, as a fixed cost to the business.*

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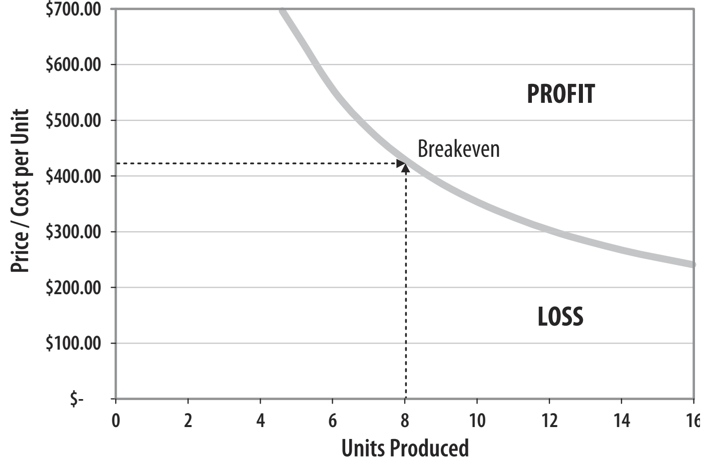
Example

Jan is a home-based potter who makes custom mugs by the case. Her capacity is no more than 15 cases of mugs per week. She has calculated the variable cost for each case, including clay, glaze and packaging to be $50 per case. It costs Jan $3,000 per week to run her business, including her wage. The cost per case, when we include the $3,000 per week in fixed costs, changes depending on the number of cases produced each week. This is calculated in the table following.

Units Produced	Fixed Costs	Variable Costs	Price Per Unit
5	$ 3,000	$ 250	$ 650
6	$ 3,000	$ 300	$ 550
7	$ 3,000	$ 350	$ 479
8	**$ 3,000**	**$ 400**	**$ 425**
9	$ 3,000	$ 450	$ 383
10	$ 3,000	$ 500	$ 350
11	$ 3,000	$ 550	$ 323
12	$ 3,000	$ 600	$ 300
13	$ 3,000	$ 650	$ 281
14	$ 3,000	$ 700	$ 264
15	$ 3,000	$ 750	$ 250

Notice that the break-even is not a point, but it varies for each different price point. If she can get $425 per case for her mugs, she needs to be able to produce and sell eight cases of mugs per week. We can plot this on a graph as follows:



The area above the line is profit and the area below the line represents loss.

Break Even with a Gross Profit Margin

Sometimes, a company does not sell products, or it sells so many different products that doing a break-even for each unit does not make sense. When this is the case, such as in a retail business, we calculate the break-even in revenue rather than in units.

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This is done with the following formula:

$$\frac{\textbf{Fixed Costs}}{\textbf{Gross Margin}} = \textbf{Break-even in Units}$$

Where:

$$\frac{\textbf{(Price - Cost)}}{\textbf{Price}} = \textbf{Gross Margin}$$

There are industry standard financial ratios available from Industry Canada for many small businesses. They are found at the Strategis website www.strategis.ic.gc.ca.

Fixed Costs

Example

Sarah wants to start a retail gift store. She estimates her monthly fixed costs at $9,000 per month. She determines that the industry standard Gross Margin for a gift store is 45%. She calculates her break-even as follows:

$$\frac{\textbf{\$9,000}}{\textbf{45\%}} = \textbf{\$20,000 per month}$$

Sarah must be convinced that this location is able to sell at least $20,000 per month (or $240,000 per year) before she starts her business. Her market research, physical location, promotional plans and physical size must all support at least this level of sales capacity or the business will not work.

The break-even is a great first step in *evaluating* business opportunities. The business should make a profit, but the break-even is often the first step in determining the viability of a business idea.

The Balance Sheet

The Balance Sheet is a snap shot of the business at any point in time. In the case of a business start-up, it is often the starting balance sheet. A balance sheet is made up of three parts.

Assets: Things a business owns
Liabilities: Debts a business owes
Equity: The owners' investment and re-investment in the business

Everything that the business owns (its assets) must bepaid for; free of debt owing. Therefore we get the following formula:

Assets = Liabilities + Equity

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This is extremely important as it gives the reader a picture of how the business is being financed through the owners' money (equity) or through the creditors' money (liabilities). In a business start-up you should look at the assets required to get the business started – and then ask yourself how you will finance that start-up. If you do not have the money to invest into the business, you will have to borrow the remainder.

Sample Balance Sheet

XYX COMPANY LTD.
Year Ending July 31, 2005

Assets		**Liabilities**	
Current Assets		*Current Liabilities*	
Cash	$5,000	Line of Credit	$2,000
Accounts Receivable	$10,000	Accounts Payable	$1,500
Inventory	$4,000	Wages Payable	$1,000
Pre-Paid Insurance	$1,200	Current Portion of Term Debt	$2,000
Total Current Assets	**$20,200**	**Total Current Liabilities**	**$6,500**
Capital Assets		*Non-Current liabilities*	
Macheriny & Equipment	$18,000	Term Loan	$20,000
Automobiles	$20,000	Less Current Portion	-$2,000
Leasehold Improvements	$24,000	Shareholders Loan	$30,000
Total Capital Assets	**$62,000**	**Total Non Current Liabilities**	**$48,000**
		Equity	
		Initial Investment	*$20,000*
		Retained Earnings	*$7,700*
		Total Equity	**$27,700**

How to Do a Balance Sheet for A Business Start-up

This section relates to the Start-up Costs section of the template.

The start-up balance sheet is simple if you know how to make and sort a list. You need to make two lists to get started. The first list is your list of *Current Assets*. These are assets (things your business owns) which will be used up within the first year of doing business. Typically they include cash, inventory and pre-paid expenses (such as pre-paid insurance). Although Accounts Receivable is another example of a current asset, there are no accounts receivables in a business start-up.

The second list is the *Capital Assets*. These are items you purchase with the intention of keeping them and using them to run the business. For example, if you purchase a vehicle to use in the business, it is a capital asset. If you purchase a vehicle to re-sell it, however, then that vehicle is inventory.

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Sometimes there is a third asset list. These are known as Intangible Assets and are things such as franchise fees, goodwill, quotas, licenses, patents and trademarks. These are not common in most business situations except where you are purchasing an existing business.

Forecasting Your Assets

A: Determine and Budget your Current Assets

Starting Cash (You must have enough to cover your start-up expenses)	$ ________
Starting Inventory	$ ________
Pre-Paid Expenses (Usually Insurance)	$ ________
Other Current Assets	$ ________
Total Current Assets (A)	**$ ________**

B: Determine your Capital Asset needs.

Machinery and Equipment	$ ________
Office Furnishings, Fixturing & Other	$ ________
Automobiles	$ ________
Computers and Data Processing Equipment	$ ________
Leasehold Improvements	$ ________
Tools and other assets valued at Less than $200	$ ________
Computer Software (Excluding Systems software)	$ ________
Other Capital or Intangible Assets	$ ________
Total Capital Assets (B)	**$ ________**
Your Total Assets are A + B	**$ ________**

Your second step is to determine how you are going to *finance* this total. What combination of Debt and Equity will allow you to get your business started?

Forecasting your Liabilities and Equity

This section relates to the Financing and Balance Sheet section of the template.

Now that you have an estimate of how much you need to get started, you must determine how best to finance your business start-up. There are only two places this money comes from when you are starting up – loans or investment. Venture Capital for start-up businesses is exceedingly rare. Most businesses are financed through three sources: the owners, their suppliers and the bank!

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There are typically three sources of debt financing in a business start-up. They are:

Supplier Credit: Sometimes a supplier will provide credit to their customers. Usually this is for inventory, however some suppliers will provide longer term financing for equipment or automobiles. Either way it is considered as a loan to the company. Supplier credit is not always afforded to a new business, so you may need to finance your starting inventory with bank debt or equity.

Bank Term Loan: A bank term loan is usually used for financing the capital assets of the business. It can sometimes be used to finance part of a business start-up or business acquisition. The loan is repaid over a period of time, and the interest rate may be fixed or floating.

Bank Line of Credit: This is similar to an overdraft for a business. It is important to use the line of credit to finance *current* assets and the term loan to finance *capital* assets. One sure way to have a cash flow crunch is to have used all your cash and line of credit to purchase a piece of equipment, only to run out of cash due to a late paying customer. It is not usual to finance a business start-up with a line of credit. It is, however, acceptable to finance short-term cash deficits using your line of credit.

Shareholders Loans: This can only happen in a limited company. You, as a shareholder, lend money to the corporation. This is an alternative method of investing in the company. Seek professional advice before deciding if using a shareholder loan is the best strategy for your business start-up.

Investment: This is the equity investment you put into your own company. The other type of equity is *Retained Earnings*, which are the profits, after income tax, kept in the business to ensure its growth. (Keep in mind there is no retained earnings in a start-up company).

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Using the information dicussed above you can create the

Starting Balance Sheet

Assets

Current Assets

Cash

Inventory

Pre-paid Expenses

A Total Current Assets **$** ________

Capital Assets

Machinery and Equipment

Office Furnishings, Fixturing and Other

Automobiles

Computers and Data Processing Equipment

Leasehold Improvements

Tools and other assets valued at less than $200

Computer Software (excluding systems software)

Other Capital or Intangible Assets

B Total Capital Assets **$** ________

A+B Total Assets **$** ________

Liabilities

Current Liabilities

Line of Credit

Supplier Credit

C Total Current Liabilities **$** ________

Non Current Liabilities

Term Loans

Vendor Credit

Shareholder Loans

D Total Non Current Liabilities **$** ________

C+D Total Liabilities **$** ________

Equity

Investment

E Total Equity **$** ________

C+D+E
Total Liabilities + Equity **$** ________

Note that ***Total Assets*** **(A+B)** are equal to ***Total Liabilities + Equity*** **(C+D+E)**

The Income Statement Forecast

This section relates to the Pro Forma Income Sheet in the template.

The purpose of the Income Statement Forecast is to project the revenues and expenses of your business over a given period of time – usually one year. Other terms for this are budgeted income statement or pro forma income statement. There are three things that need to be predicted to forecast your income statement: the sales projection, the cost of goods projection and the overhead projection.

The Sales Forecast

The sales forecast is probably the most difficult part of the business to forecast, especially for a starting business. Sometimes, the break-even can provide a starting point for creating the sales forecast. A sales forecast is not like a weather forecast. A weather forecast is something you try to forecast, but something over which you have no control. A sales forecast is a goal you set for the business that you proactively try to achieve. In the case of an existing business, you should look at the sales history. You should see if your sales are trending up or down, and then account for new products to be added, or old products to be taken away. The sales forecast

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must reflect your business strategies and objectives.

Forecasting using the Unit Method

List all the products or services you plan to sell. You will need to forecast the number of units of each type you plan to sell. Different businesses and industries use different unit measures (e.g., for a craftsperson, a unit may be one wooden item; for a researcher, a unit could be one hour of time). You will have to estimate the selling price for each unit. You can then develop a sales forecast using the following equation:

Price per unit × Number of Units sold = Revenue

Your marketing section must support sales volume and price and your operating section must support this level of production. Demonstrate that you can make this number of units, sell this number of units and justify the price you charge.

Forecasting with the Sales Method

Sometimes a business cannot use unit sales, as it would be impossible to predict the unit sales for each of 5,000 items in a gift store. In this case, some business owners will go directly to revenue forecast. If the business is broken down into logical departments or categories, then forecast the revenue in each area for the total sales forecast. Try to compare this to the market size and the number of competitors in the market.

The Cost of Goods Forecast

The cost of goods forecast relates directly to the sales forecast. The cost of producing goods varies directly with the level of sales. To calculate the cost of goods forecast, you may use either the unit costing method or the percentage cost method.

Unit Costing Method

This method is exactly like the unit sales forecast, except instead of using price, you use cost per unit.

Cost of goods = Number of units sold x Cost per unit

Just as in the unit forecast, you must do this for each unit sold. The sum of the cost of goods is then part of the income statement.

The Percentage Cost Method

In retail businesses, where mark-ups and markdowns predominate, it is common to use the cost complement to calculate the cost of goods. The cost complement is the percent of the revenue, or the selling price, which represents the cost of goods. For example, if an item costs $12.00 and is priced at $20.00 then the cost complement is $12.00 / $20.00 = 60%. (If the cost complement is 60% then the Gross Profit Margin is 40%). You can use the historical cost complement or industry standards to forecast the cost of goods and gross profit for your income statement.

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The Overheads Forecast

The overheads forecast is an estimate of your expenses for the year. This list should be similar to the list developed for the fixed costs of your break-even analysis. Typical overhead expenses include:

- Advertising and Promotion
- Automobile
- Bank and Finance Charges
- Communications
- Depreciation
- Insurance
- Entertainment and Meals
- Occupancy
- Owners' Drawing or Wage
- Mail and Office Supplies
- Professional Fees
- Professional Development
- Wages and Benefits
- Travel and Accommodations
- Other

The next step is to make cost estimates for each area. You may do them monthly, or annually, however, you will eventually need to know your monthly expenditure in each area for your cash flow forecast. Some of your forecasts will be a matter of calling a supplier and asking for a quote – insurance is an example of this kind of overhead. Sometimes, you will have to make a management decision about how much you plan to spend in order to achieve your revenue objectives.

If you have a business history, you should use that history as a guide, making sure that increases and decreases in cost are consistent with your revenue objectives.

You should make a brief note to the reader of the plan, describing the key expense of forecasted items (i.e. you may have a quote from a broker for your insurance projection). This is especially true if, in an existing business, there is a large change in the statement.

Note: *The term draw in a Proprietorship refers to the money that the owner takes out of the company. The profits kept in the business are known as retained earnings. These earnings are reflected in the owners' equity portion of the balance sheet. It should also be noted that in a proprietorship, income tax is paid on the net profit – not the owner's draw.*

Sample Income Statement

XYX PROPRIETORSHIP

Income Statement

Year Ending December 31, 2001

Sales	**$130,000**
Less Cost of Goods	78,000
Gross Profit	52,000
Expenses	
Advertising	1,500
Depreciation	5,000
Interest	2,000
Rent	4,000
Travel	600
Wages	7,000
Total Expenses	**$20,100**
Net Profit	$31,900
Less Owner's Draw	30,000
Net Profit after Draw	**$ 1,900**

The Cash Flow Forecast

This involves three parts of the template. The Cash Flow Information sheet, the Seasonality sheet and the resulting Cash Flow.

A Cash Flow Forecast is probably your most important financial tool. It is your cash flow that shows you if, and when, you will run out of cash essential to run your business. It allows you to take action before problems occur and even do "what if"

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calculations before taking on new projects. The cash flow is a 12-month projection that forecasts the receipts and disbursements for your business. In a start-up situation, it is preferable to have a start-up month to specifically show the reader the costs incurred to start the business.

Cash flow is arguably the most important aspect of business. This is due to what is called the *Current Asset Conversion Cycle*. This is the time, in days, it takes to purchase a product or materials, produce and sell an item, and then finally collect on that item.

Current Asset Conversion example

For example, suppose a business purchases $1,000 worth of raw materials at the beginning of the month. They take one month to produce the product, one month to sell the product for $2,000 and one-month to collect their cash from their customer. If they do not receive any vendor credit for their raw materials, the process looks like this.

We have to put out $1,000 at the beginning, but do not collect $2,000 for three months. We still need to pay the overhead expenses in the interim. Without cash, or access to credit, we can go bankrupt before collection. Then we need to worry about selling the product in a timely manner and collecting in a timely manner. Failing to understand this part of business is one of the reasons that many experts in entrepreneurship and small business consider poor cash planning the single biggest cause of business failure.

Why do a Cash Flow Forecast?

Too often business owners do a cash flow forecast in their head. Putting the cash flow forecast on paper, however, will give you the following:

- A format for planning the most effective use of your cash (cash management).
- A schedule of anticipated cash receipts – follow through to see that you achieve it!
- A schedule of priorities for the payment of accounts – stick to it!
- A measure of the significance of unexpected changes in circumstances; e.g., reduction of sales, strikes, tight money situations, etc.
- A list, on paper, of all the bill paying details which have been running around in your head, keeping you awake nights.
- An estimate of the amount of money you need to borrow in order to finance your day-to-day operations. This is perhaps the most important aspect of a completed cash flow forecast.
- An outline to show you and the lender that you have enough cash to make your loan payments on time.

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Receipts

Receipts occur when cash enters the business for any reason. It is like making a deposit in your current account. The main reasons for receipts are:

- Cash sales.
- Collection of accounts receivable.
- Loan proceeds. This includes term loans, start-up loans, line of credit and notes.
- Owners' contributions. This includes both investments and shareholders' loans (shareholders' loans only happen in incorporated companies).

Disbursements

Disbursements occur when cash leaves the business for any reason. The main reasons for disbursements are:

- Cash expenses or inventory purchases.
- Payments of accounts or expenses payable.
- Loan repayment (either bank or shareholders' loans).
- Owner repayment (dividends in a corporation or drawings in a proprietorship).

In cash flow, we talk about receipts, disbursements and deficits or surpluses rather than revenue, expenses and profits or losses.

How to do your Cash Flow

The cash flow is made up of three distinctive parts: the receipts, the disbursements and the cash flow calculation. Because of the complexity of the disbursement section, this section has been broken down into a series of smaller sections. These sections are:

1) Receipts

a) Receipts from Operations
b) Receipts from Loan Proceeds
c) Receipts from Investments

2) Disbursements

a) Disbursements of Purchases / Sub Contracting / Piecework Labour
b) Disbursement of Administrative Expenses
c) Disbursements for Capital Purchases
d) Disbursements for Debt Repayment or Dividends

3) Cash Flow Calculation

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For business start-ups only

The Start-up column is used in start-up situations only. It is used for all of the receipts and disbursements that occur as a part of starting a business. This includes purchasing fixed assets, incurring start-up expenses, the initial investment to start the business and the initial bank loans. It is helpful to separate start-up costs from ongoing costs, so the reader can quickly see why you may have large deficits in the early stages of business development. Detailing Start-up expenses makes your cash flow easier to understand.

Part One - Receipts

1) **Forecast your sales on a monthly basis.** This must match the annual revenue forecast from the pro-forma income statement. It is not sufficient to simply divide by 12 and forecast the same level of sales in each month, rather you must base the monthly forecast on the seasonal nature of the business and the growth of the business.
2) **Forecast the receipts from operations** based on your accounts receivable assumptions. In a cash business, the sales forecast is the same as the revenue forecast. In a business that offers terms, there is a time delay between when the sale is made and the receivable is collected. For example, you might bill your clients in January (revenue) but get paid in February (cash receipt). Any sales that are not collected by the end of the year appear on the year-end balance sheet as accounts receivable.
3) **Forecast the receipts from term loans and investments.** Any *initial* investments or receipts of term loans, seen on the starting balance sheet, should appear in the start-up month. Any subsequent investment or loan receipts will be forecast in the month in which they will be received.
4) **Add up the total receipts.**

Part Two - Disbursements

1) **Forecast your variable costs or purchases on a monthly basis.** This involves pre-planning your purchases of inventory. Sometimes you simply replace the inventory you have used during the previous month. Sometimes you will plan to build up your inventory prior to busy sales periods. Once this forecast has been made, forecast your disbursement in this area. If you pay cash for these purchases, the disbursement is equal to the purchase. If you have credit terms from the suppliers, then the purchase in one month becomes a disbursement from accounts payable the following month. *(For example, a purchase in January becomes a disbursement in February.)*
2) **Forecast your overhead expenses on a monthly basis.** These are usually forecast in one of three ways:

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a) Evenly throughout the year. Lease payments would be an example of this kind of forecast.
b) As a percentage of sales. Advertising is often disbursed this way.
c) Manually, when you know a payment is due. For example, a business licence is due every January.

3) **Forecast any principal repayments to loans.** Blended monthly payments (principal and interest) should also be accounted for here, as long as the interest is not double counted.
4) **Forecast any purchases of Capital Assets** you plan to make throughout the year. If you purchase them to start your business, account for these purchases in your start-up month.
5) **Forecast any dividends, or repayments of shareholders loans.**
6) **Add up the total disbursements.**

Part 3 - The Cash Flow Calculation

The cash flow calculation measures the end of the month cash balance with the following formula:

cash balance + cash receipts - cash disbursement = end of month cash balance.

The end of month cash balance becomes the starting cash balance of the next month. Repeat this calculation for every month.

Example - Larry's Lawn Care

Receipts

Larry is planning to start a landscaping company. He will invest $10,000 in the business, borrow $5,000 to start the business. He has forecast his revenue to be $36,000 in the first year. He realizes that his business is seasonal, so he forecasts the following monthly revenue.

	Start-up	J	F	M	A	M	J	J	A	S	O	N	D	Total
Revenue		1,000	1,000	2,000	3,000	4,000	4,000	5,000	5,000	6,000	2,000	2,000	1,000	**36,000**

Larry believes that half of his sales will be cash sales, and the other half will be invoiced and paid the following month. He then accounts for his initial investment and his bank loan to complete the receipts section. (Note the relationship between the receipts and the revenue.)

	Start-up	J	F	M	A	M	J	J	A	S	O	N	D
Revenue		1000	1000	2000	3000	4000	4000	5000	5000	6000	2000	2000	1000
Receipts													
Cash		500	500	1000	1500	2000	2000	2500	2500	3000	1000	1000	500
AR			500	500	1000	1500	2000	2000	2500	2500	3000	1000	1000
Investment	10000												
Loan	5000												
Total	**15000**	**500**	**1000**	**1500**	**2500**	**3500**	**4000**	**4500**	**5000**	**5500**	**4000**	**2000**	**1500**

Of January's sales, $500 is received in January and $500 in February.

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Disbursements

Larry estimates he will spend about 10 per cent of his revenue on variable costs. He receives 30-day credit terms from a local landscape supply company – so the costs incurred for January will be disbursed in February. (These disbursements will be made as Accounts Payable.)

Larry estimates start-up expenses of $300, monthly expenses of $500 and a monthly draw of $1500. He plans to purchase $5000 in gardening equipment a $1,000 trailer and a $2000 computer system. Larry's disbursements will look like this:

	Start-up	J	F	M	A	M	J	J	A	S	O	N	D
Cost of Goods		100	100	200	300	400	400	500	500	600	200	200	100
Disbursements													
AP			100	100	200	300	400	400	500	500	600	200	200
Overheads	300	500	500	500	500	500	500	500	500	500	500	500	500
Draw		1500	1500	1500	1500	1500	1500	1500	1500	1500	1500	1500	1500
Equipment	5000												
Trailer	1000												
Computer	2000												
Total	**8300**	**2000**	**2100**	**2100**	**2200**	**2300**	**2400**	**2400**	**2500**	**2500**	**2600**	**2200**	**2200**

Cash Flow Calculation

Take the Total Receipts line and the Total Disbursements line and forward them to the appropriate lines below. Then apply the following formula to the cash flow:

Starting Cash Balance + Receipts - Disbursements = Ending Cash Balance

Forward the ending cash balance to next month's Starting Cash Balance

	Start-up	J	F	M	A	M	J	J	A	S	O	N	D
Cash Balance	0	6700	5200	4100	3500	3800	5000	6600	8700	11200	14200	15600	15400
Plus Receipts	15000	500	1000	1500	2500	3500	4000	4500	5000	5500	4000	2000	1500
Less Disbursements	8300	2000	2100	2100	2200	2300	2400	2400	2500	2500	2600	2200	2200
Equals Ending Balance	6700	5200	4100	3500	3800	5000	6600	8700	11200	14200	15600	15400	14700

Since there are no cumulative deficits, we can continue. If the cash balance were forecast to be negative at any point, then we would have to reduce expenditures, increase initial investment, increase revenue, or arrange for a line of credit from the bank.

Although this is a very simple example of a cash flow, it should give you an idea of how to construct a cash flow for your situation. Your template does these calculations automatically – allows you to make adjustments if there are any negative balances. (If you have a negative cash balance, you are using your overdraft / line of credit to finance this deficit.) By going through each screen, you will create a first draft of your starting balance sheet, pro-forma income statement and cash flow forecast.

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Notes to your Pro Forma Statements

Many entrepreneurs fail to include adequate notes and explanations to their pro-forma financials. The reader must be able to clearly understand what is being assumed within the sales numbers, salaries, and other significant figures by including detailed and well explained "notes to financials". You will also have more credibility if you compare your pro-forma statements, especially your income statement, to outside benchmarks. A great source for these benchmarks is found in *Performance Plus*. This is a part of the *Strategis* Website provided by Industry Canada. It is found at: http://strategis.ic.gc.ca/epic/internet/inpp-pp.nsf/en/h_pm00059e.html There are also books on Key Financial Ratios available in the reference sections of many public libraries.

Financing Your Business

There are two main types of financing – equity financing and debt financing. Equity is the investors' financial stake in the business. With equity financing, an investor makes money available for use in exchange for an ownership share in the business. This could be as a silent or limited partner (not actively involved in the business) or as a shareholder. Whether equity financing is possible or a good option depends on the business structure and relationship between the borrower and lender. As a business grows and profits are made they can remain in the business. This is called *retained earnings*. A company with no debt is financed completely by the shareholders or owners. In such a company the investments and profits finance the company's assets.

With debt financing, the lender charges interest for the use or rental of money loaned, but does not get a share or equity in the business. Debt financing is familiar to most people because it is the basis of most personal credit. Debt often comes from banks, but it can also come in the form of supplier credit (accounts payable) or in the form of vendor credit for capital purchases.

Bank Financing

Many entrepreneurs will go to the bank for part of their business financing. This can be financing the start-up of the business or financing the growth of an existing business. Either way, bank financing plays a major part in the development of small business. Banks use a variety of tools to finance business. The two main types are Lines of Credit and Term Loans.

Line of Credit

Line of credit is a loan similar to a personal overdraft and is used to finance temporary shortages in cash caused by inventory and accounts receivable. It is sometimes disbursed into your chequing account in increments of $5,000. The interest rates are often variable and based on the prime lending rate.

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A line of credit is often subject to margin requirements. For example, a condition of your line of credit might be that the total credit available is the lesser of $200,000 or 75 per cent of current receivables and 50 per cent of inventory. You must report to the bank on a monthly basis, so make sure you have done all your invoicing before month end so it is included in your margin calculation.

Many business owners will purchase capital assets, such as machinery or equipment using their line of credit. This can create a cash flow crisis, since the credit required to finance the inventory and receivables is tied up financing the current asset. Be careful to use the right form of financing for the proper purpose.

Term Loans

Term loans are loans that are repaid over a fixed period of time – usually more than one year. A business may have several term loans at the same time financing different projects or assets. Term loans may or may not have fixed interest rates, depending on the terms and conditions. Usually, term loans are used to finance capital assets, although sometimes term loans are taken out to increase cash levels (current assets) in the business.

Leases

Leases are similar to term loans. They are often called capital leases as the business has use of the asset, and an obligation to make the lease payment.

When you develop your starting balance sheet, compare the owners' contributions to those of outside parties. This is called the Debt to Equity ratio. It shows how much money was invested for every dollar borrowed. The risk is directly related to the capital committed to the project. You cannot expect banks and lending institutions to take more risk than you take in the business.

Lending Criteria

Many banks use the four C's to evaluate loan proposals. They represent:

Cash Flow:

The ability to repay the loan with cash. This is measured using the Cash Flow Forecast in your business plan.

Collateral:

The value of internal and external security that may be liquidated. This is measured by taking the market value of the business assets and comparing this value to all outstanding term debts. This determines what might happen if the business defaults on the loan. Sometimes an asset outside of the business will secure a business loan. This is external security. An associated company may hold the asset or it may be a personal asset of the business owner. (See loan guarantees.)

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Character:

Aspects about the business owner or owners, which lead you to believe in their credit worthiness. Banks often use the business owners' personal history to determine attitudes towards credit. They will also look at the technical and business skills presented in the business plan.

Commitment:

The financial commitment by the owners in this business venture. This is measured by examining the equity or shareholders loans in the business, and the retained earnings history of the business.

Statement of Personal Net Worth

A statement of personal net worth is a measure of the wealth of the owner or owners of the business. It is similar to a balance sheet – except those assets are measured at their market value. The formula for net worth is:

Net Worth = Assets (Market Value) – Liabilities

Personal Loan Guarantees

When a small corporation borrows money from a bank, the shareholders will often be required to sign what is known as a personal loan guarantee. This is like the individual co-signing a loan granted to the corporation.

It means that if the corporation (business) defaults on the loan then the individual shareholders must re-pay for the corporation. It is not unusual for the spouses of shareholders to sign guarantees as well. This prevents the guarantor (the person who signs the guarantee) from transferring their net worth to their spouse. Personal loan guarantees are required for most business loans. Always remember that the guarantee is a legal document, and it is advisable to see a lawyer before signing any such document. Couples will often be required to seek independent legal advice before signing a personal loan guarantee.

Program and Financing

(Also known as source & application of funds)

The program and financing is a description of the loan requirement and the asset purchase. It looks like a small balance sheet in that it states what you are going to purchase, and how you are going to pay for it.

Supposing that X Proprietorship wants to purchase a $5,000 piece of equipment. They decide to borrow $3,000 use $1,000 of the businesses' cash, and invest an additional $1,000 into the company.

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The starting balance sheet, program and financing and pro-forma balance sheet would look like this:

	Starting Balance Sheet	Program and Financing	Pro-Forma Balance Sheet
Assets			
Current Assets			
Cash	$3,000	-$1,000.00	$2,000
Inventory	$15,000		$15,000
Accounts Receivable	$12,000		$12,000
Total Current Assets	**$30,000**		**$30,000**
Capital Assets			
Book Value (Vehicle)	$15,000		$15,000
Book Value (Equipment)	$12,000	$5,000.00	$17,000
Total Capital Assets	**$27,000**		**$27,000**
Total Assets	**$57,000**		**$57,000**
Liabilities			
Current Liabilities			
Trade Payables	$2,000		$2,000
Wages Payable	$3,000		$3,000
Line of Credit	$5,000		$5,000
Total Current Liabilities	**$10,000**		**$10,000**
Long Term Debt			
Term Loan	$10,000	$3,000	$13,000
Note Payable	$6,000		$6,000
Total Term Debt	**$16,000**		**$16,000**
Total Liabilities	**$26,000**		**$26,000**
Owners Equity	**$31,000**	**$1,000**	**$32,000**
Total Liabilities and Owners Equity	**$57,000**		**$57,000**

The program and financing and the statements of personal net worth must be provided along with the business plan to ensure the credit-worthy nature of the business venture.

Where to access financing

Contrary to popular myth, very few businesses start with any form of venture capital outside of family and friends. Sometimes, businesses will get venture capital through angels, people who specialize in helping business get started, but only after a product has been developed or a market has been established. Owner investment and debt financing are the most common means of financing a business.

Canadian Chartered banks have made every attempt to streamline the business loan application. Recently, the credit application process for business loans, even for start-up loans, has been reduced to single page applications. Loans for up to $50,000 are readily available, even to new businesses or business start-up situations.

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These loans are based on the personal net worth of the principal owners of the business and the credit history of these principals. Don't forget credit unions, who tend to know their local economies very well, and if you are in a rural or smaller urban centre, try the Community Futures Development Corporation (CFDC) in your area. To locate your nearest CFDC go http://www.communityfutures.ca.

If you do not qualify for traditional bank financing, you may be able to access financing from other sources. There are programs for:

- Aboriginal Entrepreneurs
- Young Entrepreneurs
- Women Entrepreneurs
- New Immigrants

These programs change on a regular basis so check Small Business BC at www.smallbusinessbc.ca for up-to-date information. The financing page at this site, www.smallbusiness.bc.ca/financing, provides information on government, private and venture capital sources of financing. Industry Canada's Strategis site, www.strategis.ic.gc.ca also has extensive information on financing. Click on Business Support, Financing located in the left-column menu.

A hallmark of entrepreneurial thinking is the person who thinks of alternatives. This includes alternatives to start-up costs, like buying used equipment instead of new equipment – alternative product lines that are easier to manufacture and of course researching new venues for marketing your product.

A final word on your Financial Plan

A common mistake made by many businesses is developing a financial plan for a bank or an investor, and then promptly putting it away and forgetting all about it. Your financial plan should be reviewed every month. Check your plan against the actual. This will help you anticipate problems before they arise.

After completing your financial plan, you should re-examine the entire business concept in light of the results. Ask yourself if this is a good investment of your money and your time. Is the financial reward worth the lifestyle change? These are personal questions, which should be asked before that fateful trip to the bank. *It is easy to quit a job, it is difficult to quit a business!* The completed financial plan spells out the financial risks and rewards required for your new business. Only you can determine if it is worth the risk.

Finance is difficult for most entrepreneurs. Use professionals such as accountants or consultants to help you make sense of your financial statements. Financial plans and financial statements are a critical part of managing your business. Good luck with your planning and with your business.

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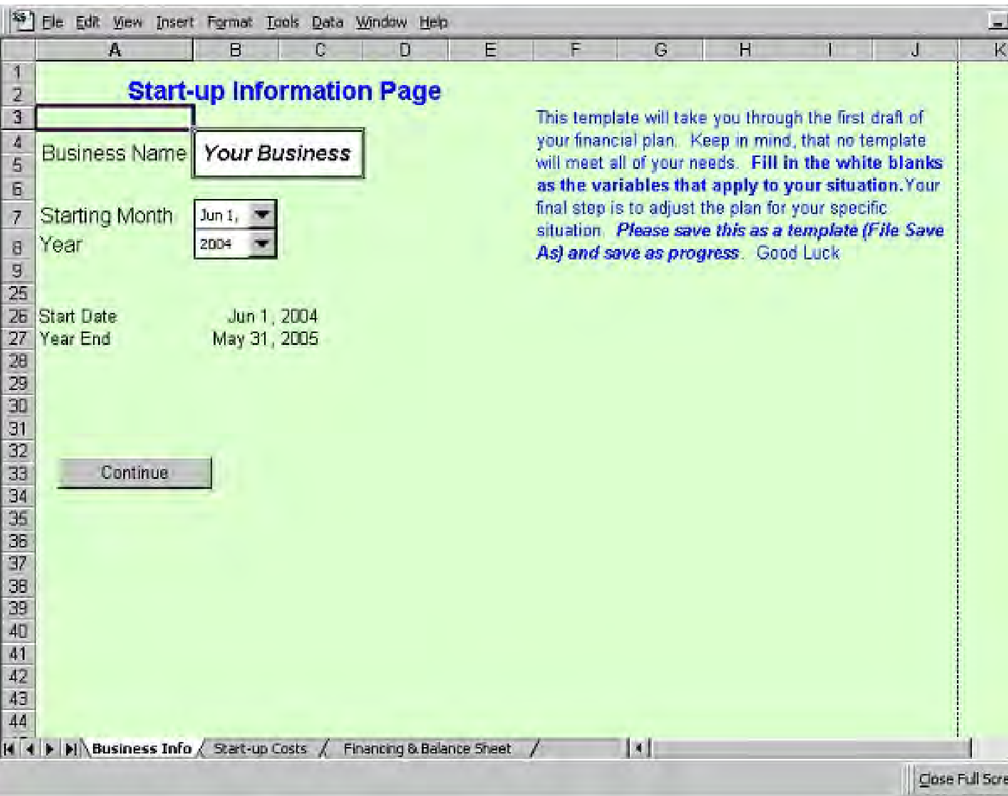
The Financial Template

A Brief Operating Guide

If you are working with a print-out of this document you can locate the Excel template by clicking here or going to http://www.cse.gov.bc.ca/ReportsPublications/FinancialTemplate.XLT.

Start-up Information Page



This is the starting page. The white cells are for required information. On this page you must:

1. **Type** in the name of the business
2. **Select** the starting month and year from the drop down menu. You must have a starting point at the beginning of the month.
3. **Select** continue and the start-up costs page will appear.

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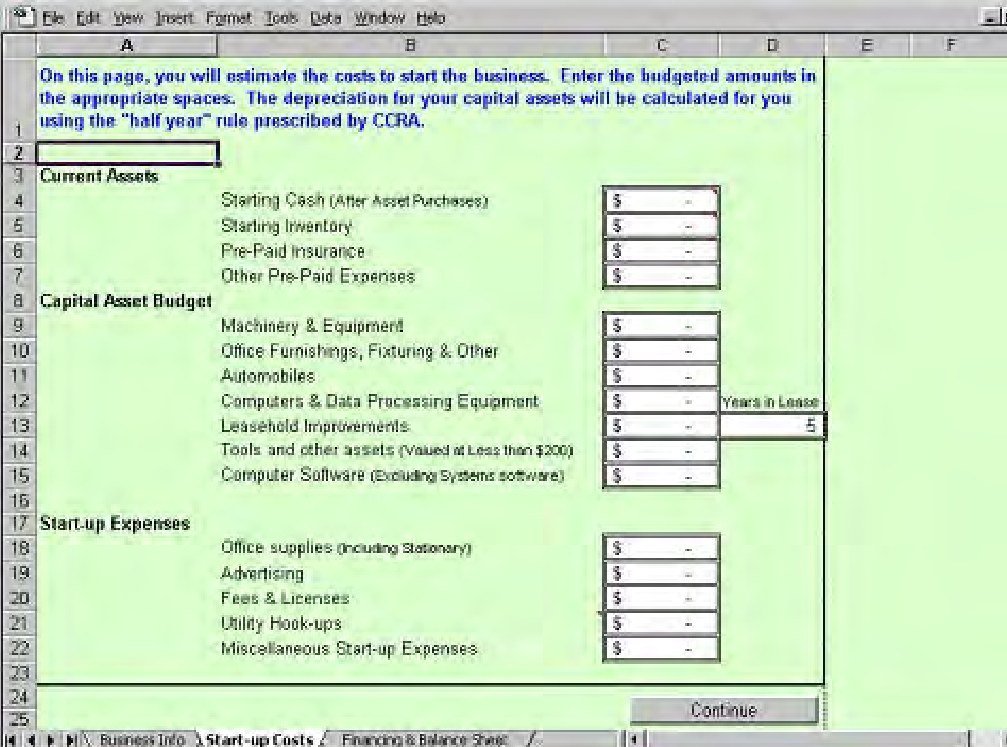
Start-up Costs Page



This page is to document your start-up costs. You must estimate how much it will cost to start your business. We recommend you "Save As" an .xls worksheet as your first step. This way, your original blank template remains intact.

Current Assets

1. **Estimate** the amount of cash you will have in the bank after purchasing your other assets. It must be at least as great as your start-up expenses if you plan to avoid a cash deficit before you start. You will also estimate your starting inventory and your pre paid expenses. (Remember that you can always re-visit this page after you have completed your first draft and change these estimates based on sales and cash flow.)
2. **Estimate** your capital asset requirements. Capital assets are things you generally keep for longer than one year. The depreciation on these assets (an income statement item) is automatically calculated for you using the prescribed CCA percentages from Canada Revenue Agency (CRA). Except for Leasehold Improvements, depreciation is calculated using the "declining balance" method and uses the CRA half-year rule.
3. **Start-up expenses** are non-asset purchases incurred prior to starting the business.

Select Continue to go to the next screen

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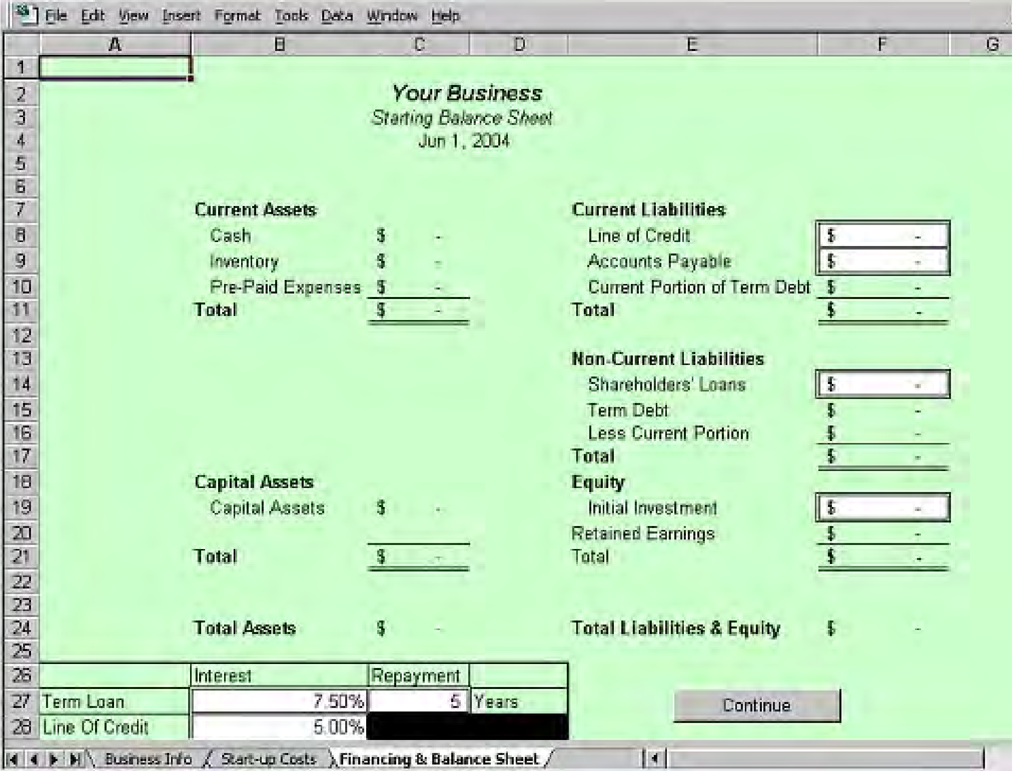
Financing & Balance Sheet



The asset information has been forwarded from your "Start-up Costs" page. You must decide how you will receive accounts payable from your suppliers for inventory, if you plan to use a line of credit to finance your business start-up (not recommended), and how much you will put into the business in terms of the initial investment and/or shareholders loans. *The remainder will automatically be borrowed in the form of a term loan.*

At the bottom of the page, you will see space for the term loan information (Interest rate and Repayment period) and the line of credit interest rate. These are defaulted at 7.5 per cent, 5 Years and 5.00 per cent respectively. Change these to the actual rates and time periods you will be paying.

Like the other pages, you can experiment with different combinations of debt and equity, and see the results on the Balance Sheet, Income Statement and Cash Flow Forecast.

Select Continue to go to the next screen.

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The Pro-Forma Income Statement

File Edit View Insert Format Tools Data Window Help

Row	Item	Start - up	Annual	Total	% to Sales
1			Your Business		
2			*Pro Forma Income Statement*		
3			May 31, 2005		
4					
5		Start - up	Annual	Total	% to Sales
6					
7	**Revenue**		$ 0	# #	100.0%
8					
9					
10	**Cost of Goods**		$ -	# -	0.0%
11					
12	**Gross Profit**		$ 0	# #	100.0%
13					
14	**Administrative**				
15	Advertising	$ -	$ -	# -	0.0%
16	Automobile		$ -	# -	0.0%
17	Bank & Finance		$ -	# -	0.0%
18	Communications	$ -	$ -	# -	0.0%
19	Depreciation		$ -	# -	0.0%
20	Equipment Lease		$ -	# -	0.0%
21	Fees & licenses	$ -	$ -	# -	0.0%
22	Interest		$ -	# -	0.0%
23	Insurance		$ -	# -	0.0%
24	Mail & Office Supplies	$ -	$ -	# -	0.0%
25	Meals & Entertainment		$ -	# -	0.0%
26	Occupancy		$ -	# -	0.0%
27	Professional Development		$ -	# -	0.0%
28	Professional Fees		$ -	# -	0.0%
29	Travel & Accommodations		$ -	# -	0.0%
30	Wages & Benefits		$ -	# -	0.0%
31	Owners' Wage or Draw		$ -	# -	0.0%
32	Miscellaneous	$ -	$ -	# -	0.0%
33	Other Expense 1		$ -	# -	0.0%
34	Other Expense 2		$ -	# -	0.0%
35	Other Expense 3		$ -	# -	0.0%
36					
37	Total Administrative Expenses		$ -	# -	0.0%
38					
39	Net Profit (Corporation)		$ 0	# #	100.0%
40					
41	Net Profit (Proprietorship)		$ 0	# #	100.0%
42					

Start-up Costs / Financing & Balance Sheet / **Pro Forma Income**

You must now forecast your income statement. This is based on your idea of annual revenue, cost of goods, and the annual overhead expenses. Note that the "Start-up Expenses" are forwarded from the Start-up expense sheet, and the depreciation and interest are calculated for you. You can try different amounts of revenue, cost of goods and overhead expenses, and immediately see the results of the change on your net profit.

The Net Profit (Corporation) represents the profit when the owners wage is subtracted, as is the case with a corporation. The Net Profit (Proprietorship) does not subtract the owners' wage or draw. *Select continue to go to the main screen.*

Note: *The revenue is defaulted at $0.1 to eliminate the #Div 0. The rounding prevents the figure from being shown.*

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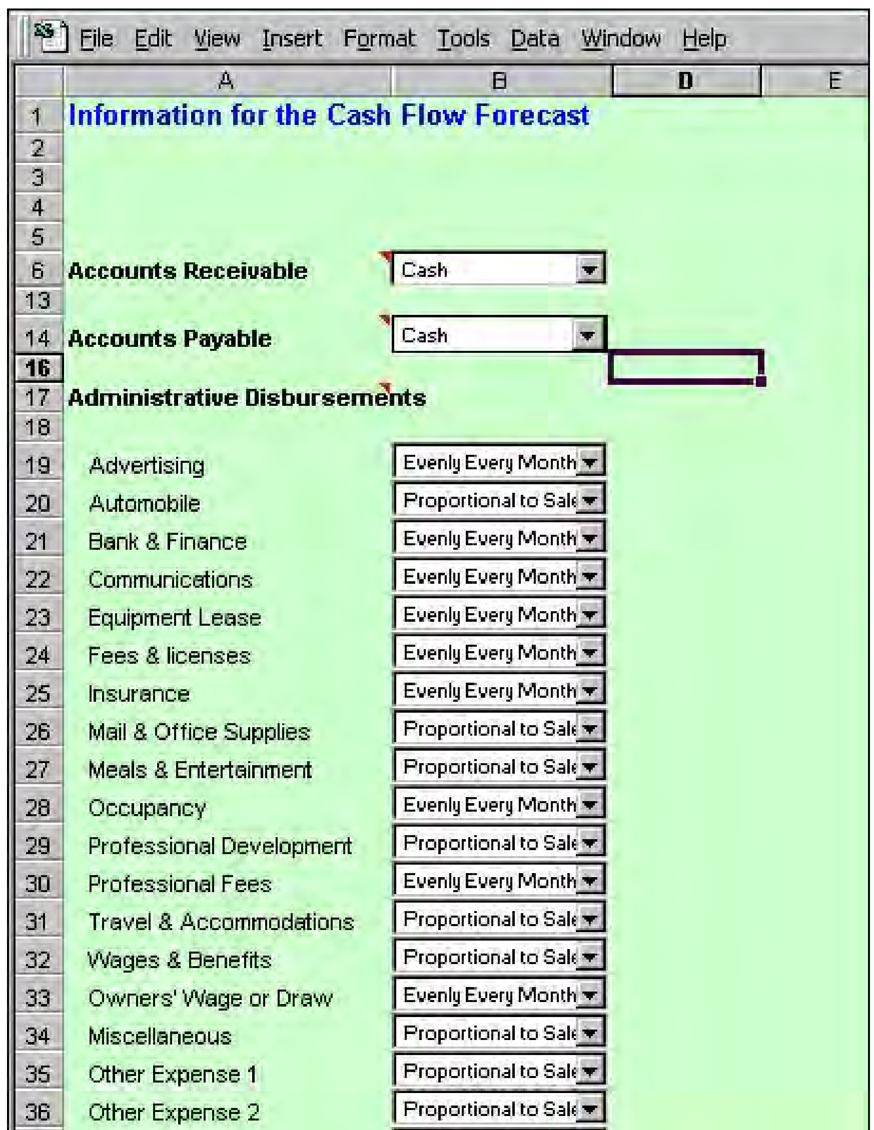
Cash Flow Information



Accounts Receivable and Accounts Payable

You may now make assumptions with respect to your Accounts Receivable and Accounts Payable. Your choices are to receive your payment, or to pay your suppliers in:

- Cash
- 15 Days
- 30 Days
- 45 Days
- 60 Days

Base this on the terms you offer your clients, and the terms you are offered by your suppliers.

Administrative Disbursements

For each of your cash disbursements, you can choose between two alternatives. The cash is disbursed evenly throughout the year or as a percentage of the monthly sales.

A lease payment, for example, would generally be paid out evenly throughout the year, however advertising is typically paid out as a percentage to sales. If there are other choices, you must make them manually when you get to the cash flow sheet. *Select Continue to go to the next sheet.*

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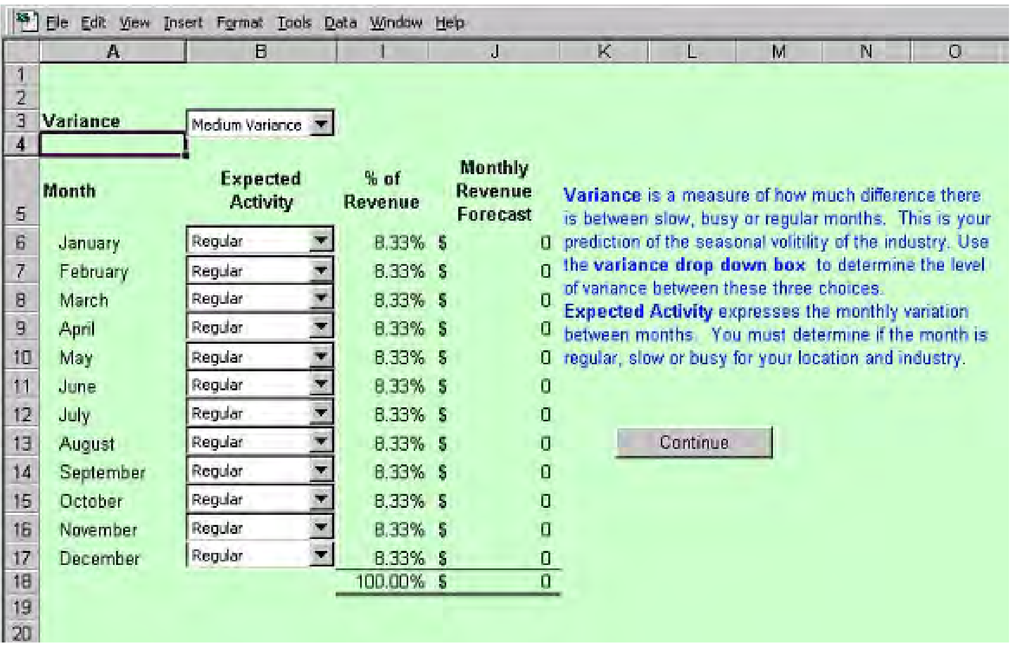
Seasonal Adjustments



The Seasonality sheet takes the annual revenue, and allocates it into different months. There are two steps to this process. Variance is the term for the difference between regular, slow and busy months. A highly seasonal industry would have high variance. A less seasonal industry would be medium or slow.

The expected activity asks for one of three choices for each month. Will it be a slow, regular or busy month? These decisions trigger a formula for a monthly percent of sales that is displayed in the percentage of sales column. The monthly revenue forecast is the percentage of monthly sales multiplied by the annual revenue, which is taken from the pro-forma income statement. You can immediately see the effect of each choice on the monthly revenue forecast.

Select Continue, and you will see your cash flow forecast.

You can now go back and change assumptions until you are happy with the results of the financial plan. Many people find it helpful to save different versions. Simply select "Save As" from the File menu to save different versions of your plan.

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Comprehensive business information and business planning resources for starting and growing a business in British Columbia
1 800 667-2272
www.smallbusinessbc.ca

BusinessGateway.ca
The Government of Canada's main site for business information
1 866 287-4283
www.businessgateway.ca

OneStop Business Registry
Online Business Registration and Change of Business Address
www.bcbusinessregistry.ca

eBC eBusiness Connection
e-business information resources for small and medium-sized businesses
1 604 775-7532
www.e-bc.ca

Investment Capital Programs
Accelerate access to capital
Venture Capital Program – Employee Ownership Program
1 800 665-6597
www.equitycapital.gov.bc.ca

Government Agents
Province-wide access to government services including key government transactions for business
1 800 663-7867 (Enquiry BC) to be transferred to the nearest Government Agents Office
www.governmentagents.gov.bc.ca

Community Futures Development Association of British Columbia
Business counseling and assistance for new and existing business in rural British Columbia
www.communityfutures.ca/provincial/bc/

Women's Enterprise Society
Business information counseling and skills training for women entrepreneurs
1 800 643-7014
www.wes.bc.ca

La Société de développement économique
The Francophone Economic Development Organization enhances the vitality of minority language communities and assists with economic development
www.sdecb.com

www.smallbusinessbc.ca

Western Economic Diversification Canada | Diversification de l'économie de l'Ouest Canada
www.wd.ca

British Columbia
Ministry of Small Business and Economic Development
www.gov.bc.ca/sbed

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How to Write a Great Business Plan

by William A. Sahlman

Reprint 97409

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Which information belongs–and which doesn't–may surprise you.

How to Write a Great

by William A. Sahlman

Few areas of business attract as much attention as new ventures, and few aspects of new-venture creation attract as much attention as the business plan. Countless books and articles in the popular press dissect the topic. A growing number of annual business-plan contests are springing up across the United States and, increasingly, in other countries. Both graduate and undergraduate schools devote entire courses to the subject. Indeed, judging by all the hoopla surrounding business plans, you would think that the only things standing between a would-be entrepreneur and spectacular success are glossy five-color charts, a bundle of meticulous-looking spreadsheets, and a decade of month-by-month financial projections.

William A. Sahlman is Dimitri V. d'Arbeloff Professor of Business Administration at the Harvard Business School in Boston, Massachusetts. He has been closely connected with more than 50 entrepreneurial ventures as an adviser, investor, or director. He teaches a second-year course at the Harvard Business School called "Entrepreneurial Finance," for which he has developed more than 100 cases and notes.

Nothing could be further from the truth. In my experience with hundreds of entrepreneurial start-ups, business plans rank no higher than 2–on a scale from 1 to 10–as a predictor of a new venture's success. And sometimes, in fact, the more elaborately crafted the document, the more likely the venture is to, well, flop, for lack of a more euphemistic word.

What's wrong with most business plans? The answer is relatively straightforward. Most waste too much ink on numbers and devote too little to the information that really matters to intelligent investors. As every seasoned investor knows, financial projections for a new company–especially detailed, month-by-month projections that stretch out for more than a year–are an act of imagination. An entrepreneurial venture faces far too many unknowns to predict revenues, let alone profits. Moreover, few if any entrepreneurs correctly anticipate how much capital and time will be required to accomplish their objectives. Typically, they are wildly optimistic, padding their projections. Investors know about the padding effect and therefore discount the figures in business plans. These ma-

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Business Plan

neuvers create a vicious circle of inaccuracy that benefits no one.

Don't misunderstand me: business plans should include some numbers. But those numbers should appear mainly in the form of a business model that shows the entrepreneurial team has thought through the key drivers of the venture's success or failure. In manufacturing, such a driver might be the yield on a production process; in magazine publishing, the anticipated renewal rate; or in software, the impact of using various distribution channels. The model should also address the break-even issue: At what level of sales does the business begin to make a profit? And even more important, When does cash flow turn positive? Without a doubt, these questions deserve a few pages in any business plan. Near the back.

What goes at the front? What information does a good business plan contain?

If you want to speak the language of investors – and also make sure you have asked yourself the right questions before setting out on the most daunting journey of a businessperson's career – I recommend basing your business plan on the framework that follows. It does not provide the kind of "winning" formula touted by some current how-to books and software programs for entrepreneurs. Nor is it a guide to brain surgery. Rather, the framework systematically assesses the four interdependent factors critical to every new venture:

The People. The men and women starting and running the venture, as well as the outside parties providing key services or important resources for it, such as its lawyers, accountants, and suppliers.

The Opportunity. A profile of the business itself – what it will sell and to whom, whether the business can grow and how fast, what its economics are, who and what stand in the way of success.

The Context. The big picture – the regulatory environment, interest rates, demographic trends, inflation, and the like – basically, factors that inevitably change but cannot be controlled by the entrepreneur.

Risk and Reward. An assessment of everything that can go wrong and right, and a discussion of how the entrepreneurial team can respond.

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BUSINESS PLANS: FOR ENTREPRENEURS ONLY?

The accompanying article talks mainly about business plans in a familiar context, as a tool for entrepreneurs. But quite often, start-ups are launched within established companies. Do those new ventures require business plans? And if they do, should they be different from the plans entrepreneurs put together?

The answer to the first question is an emphatic yes; the answer to the second, an equally emphatic no. All new ventures – whether they are funded by venture capitalists or, as is the case with intrapreneurial businesses, by shareholders – need to pass the same acid tests. After all, the marketplace does not differentiate between products or services based on who is pouring money into them behind the scenes.

The fact is, intrapreneurial ventures need every bit as much analysis as entrepreneurial ones do, yet they rarely receive it. Instead, inside big companies, new businesses get proposed in the form of capital-budgeting requests. These faceless documents are subject to detailed financial scrutiny and a consensus-building process, as the project wends its way through the chain of command, what I call the "neutron bomb" model of project governance. However, in the history of such proposals, a plan never has been submitted that did not promise returns in excess of corporate hurdle rates. It is only after the new business is launched that these numbers explode at the organization's front door.

That problem could be avoided in large part if intrapreneurial ventures followed the guidelines set out in the accompanying article. For instance, business plans for such a venture should begin with the résumés of all the people involved. What has the team done in the past that would suggest it would be successful in the future, and so on? In addition, the new venture's product or service should be fully analyzed in terms of its opportunity and context. Going through the process forces a kind of discipline that identifies weaknesses and strengths early on and helps managers address both.

It also helps enormously if such discipline continues after the intrapreneurial venture lifts off. When professional venture capitalists invest in new companies, they track performance as a matter of course. But in large companies, scrutiny of a new venture is often inconsistent. That shouldn't or needn't be the case. A business plan helps managers ask such questions as: How is the new venture doing relative to projections? What decisions has the team made in response to new information? Have changes in the context made additional funding necessary? How could the team have predicted those changes? Such questions not only keep a new venture running smoothly but also help an organization learn from its mistakes and triumphs.

Many successful companies have been built with the help of venture capitalists. Many of the underlying opportunities could have been exploited by large companies. Why weren't they? Perhaps useful lessons can be learned by studying the world of independent ventures, one lesson being: Write a great business plan.

The assumption behind the framework is that great businesses have attributes that are easy to identify but hard to assemble. They have an experienced, energetic managerial team from the top to the bottom. The team's members have skills and experiences directly relevant to the opportunity they are pursuing. Ideally, they will have worked successfully together in the past. The opportunity has an attractive, sustainable business model; it is possible to create a competitive edge and defend it. Many options exist for expanding the scale and scope of the business, and these options are unique to the enterprise and its team. Value can be extracted from the business in a number of ways either through a positive harvest event – a sale – or by scaling down or liquidating. The context is favorable with respect to both the regulatory and the macroeconomic environments. Risk is understood, and the team has considered ways to mitigate the impact of difficult events. In short, great businesses have the four parts of the framework completely covered. If only reality were so neat.

The People

When I receive a business plan, I always read the résumé section first. Not because the people part of the new venture is the most important, but because

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without the right team, none of the other parts really matters.

I read the résumés of the venture's team with a list of questions in mind. (See the insert "Who Are These People, Anyway?") All these questions get at the same three issues about the venture's team members: What do they know? Whom do they know? and How well are they known?

What and whom they know are matters of insight and experience. How familiar are the team members with industry players and dynamics? Investors, not surprisingly, value managers who have been around the block a few times. A business plan should candidly describe each team member's knowledge of the new venture's type of product or service; its production processes; and the market itself, from competitors to customers. It also helps to indicate whether the team members have worked together before. Not played – as in roomed together in college – but *worked*.

Investors also look favorably on a team that is known because the real world often prefers not to deal with start-ups. They're too unpredictable. That changes, however, when the new company is run by people well known to suppliers, customers, and employees. Their enterprise may be brand new, but they aren't. The surprise element of working with a start-up is somewhat ameliorated.

Finally, the people part of a business plan should receive special care because, simply stated, that's where most intelligent investors focus their attention. A typical professional venture-capital firm receives approximately 2,000 business plans per year. These plans are filled with tantalizing ideas for new products and services that will change the world and reap billions in the process – or so they say. But the fact is, most venture capitalists believe that ideas are a dime a dozen: only execution skills count. As Arthur Rock, a venture capital legend associated with the formation of such companies as Apple, Intel, and Teledyne, states, "I invest in people, not ideas." Rock also has said, "If you can find good people, if they're wrong about the product, they'll make a switch, so what good is it to understand the product that they're talking about in the first place?"

Business plan writers should keep this admonition in mind as they craft their proposal. Talk about the people – exhaustively. And if there is nothing solid about their experience and abilities to herald, then the entrepreneurial team should think again about launching the venture.

Who Are These People, Anyway?

Fourteen "Personal" Questions Every Business Plan Should Answer

- ☐ Where are the founders from?
- ☐ Where have they been educated?
- ☐ Where have they worked – and for whom?
- ☐ What have they accomplished – professionally and personally – in the past?
- ☐ What is their reputation within the business community?
- ☐ What experience do they have that is directly relevant to the opportunity they are pursuing?
- ☐ What skills, abilities, and knowledge do they have?
- ☐ How realistic are they about the venture's chances for success and the tribulations it will face?
- ☐ Who else needs to be on the team?
- ☐ Are they prepared to recruit high-quality people?
- ☐ How will they respond to adversity?
- ☐ Do they have the mettle to make the inevitable hard choices that have to be made?
- ☐ How committed are they to this venture?
- ☐ What are their motivations?

The Opportunity

When it comes to the opportunity itself, a good business plan begins by focusing on two questions: Is the total market for the venture's product or service large, rapidly growing, or both? Is the industry now, or can it become, structurally attractive? Entrepreneurs and investors look for large or rapidly growing markets mainly because it is often easier to obtain a share of a growing market than to fight with entrenched competitors for a share of a mature or stagnant market. Smart investors, in fact, try hard to identify high-growth-potential markets early in their evolution: that's where the big payoffs are. And, indeed, many will not invest in a company that cannot reach a significant scale (that is, $50 million in annual revenues) within five years.

As for attractiveness, investors are obviously looking for markets that actually allow businesses to make some money. But that's not the no-brainer it seems. In the late 1970s, the computer disk-drive business looked very attractive. The technology was new and exciting. Dozens of companies jumped into the fray, aided by an army of professional investors. Twenty years later, however, the thrill is gone for managers and investors alike. Disk drive companies must design products to meet the perceived needs of original equipment manufacturers (OEMs) and end users. Selling a product to OEMs is complicated. The customers are large relative to most of their suppliers. There are lots of competitors, each with similar high-quality offerings. Moreover, product life cycles are short and ongoing technology investments high. The industry is

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The Opportunity of a Lifetime – or Is It?

Nine Questions About the Business Every Business Plan Should Answer

- ☐ Who is the new venture's customer?
- ☐ How does the customer make decisions about buying this product or service?
- ☐ To what degree is the product or service a compelling purchase for the customer?
- ☐ How will the product or service be priced?
- ☐ How will the venture reach all the identified customer segments?
- ☐ How much does it cost (in time and resources) to acquire a customer?
- ☐ How much does it cost to produce and deliver the product or service?
- ☐ How much does it cost to support a customer?
- ☐ How easy is it to retain a customer?

subject to major shifts in technology and customer needs. Intense rivalry leads to lower prices and, hence, lower margins. In short, the disk drive industry is simply not set up to make people a lot of money; it's a structural disaster area.

The information services industry, by contrast, is paradise. Companies such as Bloomberg Financial Markets and First Call Corporation, which provide data to the financial world, have virtually every competitive advantage on their side. First, they can assemble or create *proprietary* content – content that, by the way, is like life's blood to thousands of money managers and stock analysts around the world. And although it is often expensive to develop the service and to acquire initial customers, once up and running, these companies can deliver content to customers very cheaply. Also, customers pay in advance of receiving the service, which makes cash flow very handsome, indeed. In short, the structure of the information services industry is beyond attractive: it's gorgeous. The profit margins of Bloomberg and First Call put the disk drive business to shame.

Thus, the first step for entrepreneurs is to make sure they are entering an industry that is large and/or growing, and one that's structurally attractive. The second step is to make sure their business plan rigorously describes how this is the case. And if it isn't the case, their business plan needs to specify how the venture will still manage to make enough of a profit that investors (or potential employees or suppliers, for that matter) will want to participate.

Once it examines the new venture's industry, a business plan must describe in detail how the company will build and launch its product or service into the marketplace. Again, a series of questions should guide the discussion. (See the insert "The Opportunity of a Lifetime–or Is It?")

Often the answers to these questions reveal a fatal flaw in the business. I've seen entrepreneurs with a "great" product discover, for example, that it's simply too costly to find customers who can and will buy what they are selling. Economically viable access to customers is the key to business, yet many entrepreneurs take the *Field of Dreams* approach to this notion: build it, and they will come. That strategy works in the movies but is not very sensible in the real world.

It is not always easy to answer questions about the likely consumer response to new products or services. The market is as fickle as it is unpredictable. (Who would have guessed that plug-in room deodorizers would sell?) One entrepreneur I know proposed to introduce an electronic news-clipping service. He made his pitch to a prospective venture-capital investor who rejected the plan, stating, "I just don't think the dogs will eat the dog food." Later, when the entrepreneur's company went public, he sent the venture capitalist an anonymous package containing an empty can of dog food and a copy of his prospectus. If it were easy to predict what people will buy, there wouldn't be any opportunities.

The market is as fickle as it is unpredictable. Who would have guessed that plug-in room deodorizers would sell?

Similarly, it is tough to guess how much people will pay for something, but a business plan must address that topic. Sometimes, the dogs will eat the dog food, but only at a price less than cost. Investors always look for opportunities for value pricing–that is, markets in which the costs to produce the product are low, but consumers will still pay a lot for it. No one is dying to invest in a company when margins are skinny. Still, there is money to be made in inexpensive products and services–even in commodities. A business plan must demonstrate that careful con-

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sideration has been given to the new venture's pricing scheme.

The list of questions about the new venture's opportunity focuses on the direct revenues and the costs of producing and marketing a product. That's fine, as far as it goes. A sensible proposal, however, also involves assessing the business model from a perspective that takes into account the investment required – that is, the balance sheet side of the equation. The following questions should also be addressed so that investors can understand the cash flow implications of pursuing an opportunity:

- ☐ When does the business have to buy resources, such as supplies, raw materials, and people?
- ☐ When does the business have to pay for them?
- ☐ How long does it take to acquire a customer?
- ☐ How long before the customer sends the business a check?
- ☐ How much capital equipment is required to support a dollar of sales?

Investors, of course, are looking for businesses in which management can buy low, sell high, collect early, and pay late. The business plan needs to spell out how close to that ideal the new venture is expected to come. Even if the answer is "not very" – and it usually is – at least the truth is out there to discuss.

The opportunity section of a business plan must also bring a few other issues to the surface. First, it must demonstrate and analyze how an opportunity can grow – in other words, how the new venture can expand its range of products or services, customer base, or geographic scope. Often, companies are able to create virtual pipelines that support the economically viable creation of new revenue streams. In the publishing business, for example, *Inc.* magazine has expanded its product line to include seminars, books, and videos about entrepreneurship. Similarly, building on the success of its personal-finance software program Quicken, Intuit now sells software for electronic banking, small-business accounting, and tax preparation, as well as personal-printing supplies and on-line information services – to name just a few of its highly profitable ancillary spin-offs.

Now, lots of business plans runneth over on the subject of the new venture's potential for growth and expansion. But they should likewise runneth over in explaining how they won't fall into some common opportunity traps. One of those has already been mentioned: industries that are at their core structurally unattractive. But there are others. The world of invention, for example, is fraught with danger. Over the past 15 years, I have seen scores of individuals who have devised a better mousetrap – newfangled creations from inflatable pillows for use on airplanes to automated car-parking systems. Few of these idea-driven companies have really taken off, however. I'm not entirely sure why. Sometimes, the inventor refuses to spend the money required by or share the rewards sufficiently with the business side of the company. Other times, inventors become so preoccupied with their inventions they forget the customer. Whatever the reason, better-mousetrap businesses have an uncanny way of malfunctioning.

Another opportunity trap that business plans – and entrepreneurs in general – need to pay attention to is the tricky business of arbitrage. Basically, arbitrage ventures are created to take advantage of some pricing disparity in the marketplace. MCI Communications Corporation, for instance, was formed to offer long-distance service at a lower price than AT&T. Some of the industry consolidations going on today reflect a different kind of arbitrage – the ability to buy small businesses at a wholesale price, roll them up together into a larger package, and take them public at a retail price, all without necessarily adding value in the process.

Whatever the reason, better-mousetrap businesses have an uncanny way of malfunctioning.

Taking advantage of arbitrage opportunities is a viable and potentially profitable way to enter a business. In the final analysis, however, all arbitrage opportunities evaporate. It is not a question of whether, only when. The trick in these businesses is to use the arbitrage profits to build a more enduring business model, and business plans must explain how and when that will occur.

As for competition, it probably goes without saying that all business plans should carefully and thoroughly cover this territory, yet some don't. That is a glaring omission. For starters, every business plan should answer the following questions about the competition:

- ☐ Who are the new venture's current competitors?
- ☐ What resources do they control? What are their strengths and weaknesses?
- ☐ How will they respond to the new venture's decision to enter the business?
- ☐ How can the new venture respond to its competitors' response?

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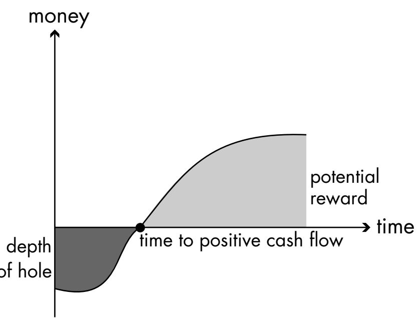
Visualizing Risk and Reward

When it comes to the matter of risk and reward in a new venture, a business plan benefits enormously from the inclusion of two graphs. Perhaps *graphs* is the wrong word; these are really just schematic pictures that illustrate the most likely relationship between risk and reward, that is, the relationship between the opportunity and its economics. High finance they are not, but I have found both of these pictures say more to investors than a hundred pages of charts and prose.

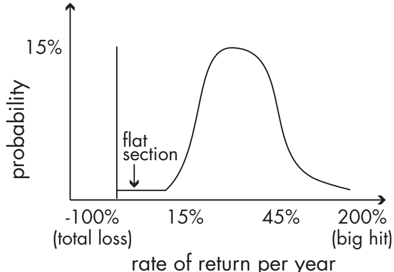
The first picture depicts the amount of money needed to launch the new venture, time to positive cash flow, and the expected magnitude of the payoff.



This image helps the investor understand the depth and duration of negative cash flow, as well as the relationship between the investment and the possible return. The ideal, needless to say, is to have cash flow early and often. But most investors are intrigued by the picture even when the cash outflow is high and long–as long as the cash inflow is more so.

Of course, since the world of new ventures is populated by wild-eyed optimists, you might expect the picture to display a shallower hole and a steeper reward slope than it should. It usually does. But to be honest, even that kind of picture belongs in the business plan because it is a fair warning to investors that the new venture's team is completely out of touch with reality and should be avoided at all costs.

The second picture complements the first. It shows investors the range of possible returns and the likelihood of achieving them. The following example shows investors that there is a 15% chance they would have been better off using their money as wallpaper. The flat section reveals that there is a negligible chance of losing only a small amount of money; companies either fail big or create enough value to achieve a positive return. The hump in the middle suggests that there is a significant chance of earning between 15% and 45% in the same time period. And finally, there is a small chance that the initial outlay of cash will spawn a 200% internal rate of return, which might have occurred if you had happened to invest in Microsoft when it was a private company.



Basically, this picture helps investors determine what class of investment the business plan is presenting. Is the new venture drilling for North Sea oil – highly risky with potentially big payoffs – or is it digging development wells in Texas, which happens to be less of a geological gamble and probably less lucrative, too? This image answers that kind of question. It's then up to the investors to decide how much risk they want to live with against what kind of odds.

Again, the people who write business plans might be inclined to skew the picture to make it look as if the probability of a significant return is downright huge and the possibility of loss is negligible. And, again, I would say therein lies the picture's beauty. What it claims, checked against the investor's sense of reality and experience, should serve as a simple pictorial caveat emptor.

☐ Who else might be able to observe and exploit the same opportunity?

☐ Are there ways to co-opt potential or actual competitors by forming alliances?

Business is like chess: to be successful, you must anticipate several moves in advance. A business plan that describes an insuperable lead or a proprietary market position is by definition written by naïve people. That goes not just for the competition section of the business plan but for the entire discussion of the opportunity. All opportunities have promise; all have vulnerabilities. A good business plan doesn't whitewash the latter. Rather, it proves that the entrepreneurial team knows the good, the bad, and the ugly that the venture faces ahead.

The Context

Opportunities exist in a context. At one level is the macroeconomic environment, including the level of economic activity, inflation, exchange rates, and interest rates. At another level are the wide range of government rules and regulations that affect the opportunity and how resources are

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marshaled to exploit it. Examples extend from tax policy to the rules about raising capital for a private or public company. And at yet another level are factors like technology that define the limits of what a business or its competitors can accomplish.

Context often has a tremendous impact on every aspect of the entrepreneurial process, from identification of opportunity to harvest. In some cases, changes in some contextual factor create opportunity. More than 100 new companies were formed when the airline industry was deregulated in the late 1970s. The context for financing was also favorable, enabling new entrants like People Express to go to the public market for capital even before starting operations.

Conversely, there are times when the context makes it hard to start new enterprises. The recession of the early 1990s combined with a difficult financing environment for new companies: venture capital disbursements were low, as was the amount of capital raised in the public markets. (Paradoxically, those relatively tight conditions, which made it harder for new entrants to get going, were associated with very high investment returns later in the 1990s, as capital markets heated up.)

Sometimes, a shift in context turns an unattractive business into an attractive one, and vice versa. Consider the case of a packaging company some years ago that was performing so poorly it was about to be put on the block. Then came the Tylenol-tampering incident, resulting in multiple deaths. The packaging company happened to have an efficient mechanism for installing tamper-proof seals, and in a matter of weeks its financial performance could have been called spectacular. Conversely, U.S. tax reforms enacted in 1986 created havoc for companies in the real estate business, eliminating almost every positive incentive to invest. Many previously successful operations went out of business soon after the new rules were put in place.

Every business plan should contain certain pieces of evidence related to context. First, the entrepreneurs should show a heightened awareness of the new venture's context and how it helps or hinders their specific proposal. Second, and more important, they should demonstrate that they know the venture's context will inevitably change and describe how those changes might affect the business. Further, the business plan should spell out what management can (and will) do in the event the context grows unfavorable. Finally, the business plan should explain the ways (if any) in which management can affect context in a positive way. For example, management might be able to have an impact on regulations or on industry standards through lobbying efforts.

Risk and Reward

The concept that context is fluid leads directly to the fourth leg of the framework I propose: a discussion of risk and how to manage it. I've come to think of a good business plan as a snapshot of an event in the future. That's quite a feat to begin with–taking a picture of the unknown. But the best business plans go beyond that; they are like movies of the future. They show the people, the opportunity, and the context from multiple angles. They offer a plausible, coherent story of what lies ahead. They unfold possibilities of action and reaction.

Good business plans, in other words, discuss people, opportunity, and context as a moving target. All three factors (and the relationship among them) are likely to change over time as a company evolves from start-up to ongoing enterprise. Therefore, any business plan worth the time it takes to write or read needs to focus attention on the dynamic aspects of the entrepreneurial process.

Of course, the future is hard to predict. Still, it is possible to give potential investors a sense of the kind and class of risk and reward they are assuming with a new venture. All it takes is a pencil and two simple drawings. (See the insert "Visualizing Risk and Reward.") But even with these drawings, risk is, well, risky. In reality, there are no immutable distributions of outcomes. It is ultimately the responsibility of management to change the distribution, to increase the likelihood and consequences of success, and to decrease the likelihood and implications of problems.

> One of the greatest myths about entrepreneurs is that they are risk seekers. All sane people want to avoid risk.

One of the great myths about entrepreneurs is that they are risk seekers. All sane people want to avoid risk. As Harvard Business School professor (and venture capitalist) Howard Stevenson says, true entrepreneurs want to capture all the reward

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A Glossary of Business Plan Terms

What They Say…	and What They Really Mean
We conservatively project…	We read a book that said we had to be a $50 million company in five years, and we reverse-engineered the numbers.
We took our best guess and divided by 2.	We accidentally divided by 0.5.
We project a 10% margin.	We did not modify any of the assumptions in the business plan template that we downloaded from the Internet.
The project is 98% complete.	To complete the remaining 2% will take as long as it took to create the initial 98% but will cost twice as much.
Our business model is proven…	if you take the evidence from the past week for the best of our 50 locations and extrapolate it for all the others.
We have a six-month lead.	We tried not to find out how many other people have a six-month lead.
We only need a 10% market share.	So do the other 50 entrants getting funded.
Customers are clamoring for our product.	We have not yet asked them to pay for it. Also, all of our current customers are relatives.
We are the low-cost producer.	We have not produced anything yet, but we are confident that we will be able to.
We have no competition.	Only IBM, Microsoft, Netscape, and Sun have announced plans to enter the business.
Our management team has a great deal of experience…	consuming the product or service.
A select group of investors is considering the plan.	We mailed a copy of the plan to everyone in Pratt's Guide.
We seek a value-added investor.	We are looking for a passive, dumb-as-rocks investor.
If you invest on our terms, you will earn a 68% internal rate of return.	If everything that could ever conceivably go right does go right, you might get your money back.

and give all the risk to others. The best business is a post office box to which people send cashier's checks. Yet risk is unavoidable. So what does that mean for a business plan?

It means that the plan must unflinchingly confront the risks ahead – in terms of people, opportunity, and context. What happens if one of the new venture's leaders leaves? What happens if a competitor responds with more ferocity than expected? What happens if there is a revolution in Namibia, the source of a key raw material? What will management actually *do*?

Those are hard questions for an entrepreneur to pose, especially when seeking capital. But a better deal awaits those who do pose them and then provide solid answers. A new venture, for example, might be highly leveraged and therefore very sensitive to interest rates. Its business plan would benefit enormously by stating that management intends to hedge its exposure through the financial-futures market by purchasing a contract that does well when interest rates go up. That is the equivalent of offering investors insurance. (It also makes sense for the business itself.)

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Finally, one important area in the realm of risk/reward management relates to harvesting. Venture capitalists often ask if a company is "IPOable," by which they mean, Can the company be taken public at some point in the future? Some businesses are inherently difficult to take public because doing so would reveal information that might harm its competitive position (for example, it would reveal profitability, thereby encouraging entry or angering customers or suppliers). Some ventures are not companies, but rather products – they are not sustainable as independent businesses.

Therefore, the business plan should talk candidly about the end of the process. How will the investor eventually get money out of the business, assuming it is successful, even if only marginally so? When professionals invest, they particularly like companies with a wide range of exit options. They like companies that work hard to preserve and enhance those options along the way, companies that don't, for example, unthinkingly form alliances with big corporations that could someday actually *buy* them. Investors feel a lot better about risk if the venture's endgame is discussed up front. There is an old saying, "If you don't know where you are going, any road will get you there." In crafting sensible entrepreneurial strategies, just the opposite is true: you had better know where you might end up and have a map for getting there. A business plan should be the place where that map is drawn, for, as every traveler knows, a journey is a lot less risky when you have directions.

The Deal and Beyond

Once a business plan is written, of course, the goal is to land a deal. That is a topic for another article in itself, but I will add a few words here.

When I talk to young (and old) entrepreneurs looking to finance their ventures, they obsess about the valuation and terms of the deal they will receive. Their explicit goal seems to be to minimize the dilution they will suffer in raising capital. Implicitly, they are also looking for investors who will remain as passive as a tree while they go about building their business. On the food chain of investors, it seems, doctors and dentists are best and venture capitalists are worst because of the degree to which the latter group demands control and a large share of the returns.

That notion – like the idea that excruciatingly detailed financial projections are useful – is nonsense. From whom you raise capital is often more important than the terms. New ventures are inherently risky, as I've noted; what can go wrong will. When that happens, unsophisticated investors panic, get angry, and often refuse to advance the company more money. Sophisticated investors, by contrast, roll up their sleeves and help the company solve its problems. Often, they've had lots of experience saving sinking ships. They are typically process literate. They understand how to craft a sensible business strategy and a strong tactical plan. They know how to recruit, compensate, and motivate team members. They are also familiar with the Byzantine ins and outs of going public – an event most entrepreneurs face but once in a lifetime. This kind of know-how is worth the money needed to buy it.

> The best business is a post office box to which people send cashier's checks.

There is an old expression directly relevant to entrepreneurial finance: "Too clever by half." Often, deal makers get very creative, crafting all sorts of payoff and option schemes. That usually backfires. My experience has proven again and again that sensible deals have the following six characteristics:

- ☐ They are simple.
- ☐ They are fair.
- ☐ They emphasize trust rather than legal ties.
- ☐ They do not blow apart if actual differs slightly from plan.
- ☐ They do not provide perverse incentives that will cause one or both parties to behave destructively.
- ☐ They are written on a pile of papers no greater than one-quarter inch thick.

But even these six simple rules miss an important point. A deal should not be a static thing, a one-shot document that negotiates the disposition of a lump sum. Instead, it is incumbent upon entrepreneurs, before they go searching for funding, to think about capital acquisition as a dynamic process – to figure out how much money they will need and when they will need it.

How is that accomplished? The trick is for the entrepreneurial team to treat the new venture as a series of experiments. Before launching the whole show, launch a little piece of it. Convene a focus group to test the product, build a prototype and watch it perform, conduct a regional or local rollout of a service. Such an exercise reveals the true eco-

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nomics of the business and can help enormously in determining how much money the new venture actually requires and in what stages. Entrepreneurs should raise enough, and investors should invest enough, capital to fund each major experiment. Experiments, of course, can feel expensive and risky. But I've seen them prevent disasters and help create successes. I consider it a prerequisite of putting together a winning deal.

Beware the Albatross

Among the many sins committed by business plan writers is arrogance. In today's economy, few ideas are truly proprietary. Moreover, there has never been a time in recorded history when the supply of capital did not outrace the supply of opportunity. The true half-life of opportunity is decreasing with the passage of time.

A business plan must not be an albatross that hangs around the neck of the entrepreneurial team, dragging it into oblivion. Instead, a business plan must be a call for action, one that recognizes management's responsibility to fix what is broken proactively and in real time. Risk is inevitable, avoiding risk impossible. Risk management is the key, always tilting the venture in favor of reward and away from risk.

A plan must demonstrate mastery of the entire entrepreneurial process, from identification of opportunity to harvest. It is not a way to separate unsuspecting investors from their money by hiding the fatal flaw. For in the final analysis, the only one being fooled is the entrepreneur.

We live today in the golden age of entrepreneurship. Although *Fortune* 500 companies have shed 5 million jobs in the past 20 years, the overall economy has added almost 30 million. Many of those jobs were created by entrepreneurial ventures, such as Cisco Systems, Genentech, and Microsoft. Each of those companies started with a business plan. Is that why they succeeded? There is no knowing for sure. But there is little doubt that crafting a business plan so that it thoroughly and candidly addresses the ingredients of success–people, opportunity, context, and the risk/reward picture–is vitally important. In the absence of a crystal ball, in fact, a business plan built of the *right* information and analysis can only be called indispensable.

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How to create an investor-grade business plan

Jul 29, 2020

John Convery discusses the critical elements of an investor-grade business plan and what investors and venture capital firms look for in an investable business.

The saying "paper never refuses ink" can certainly be applied when business plans are being written. Entrepreneurs and business owners have license to include what they want and can go overboard in producing great looking (and sounding) documents, but to what end? Venture capital firms will tell you privately how many plans pass across their desks but are discarded very quickly because they are not grounded in reality or properly thought through.

There is any number of sources that proclaim to give you the formula for "how to write a perfect plan" or "how to write a winning plan". Thanks to the web, there are now templates galore you can use in tandem. There are also multiple sites that outline what a great business plan should contain.

Writing a good plan is not an exercise in producing grandiose business models and frameworks, with dazzling technical language and 2-D diagrams in brilliant, sharp colours and padding the whole lot off with forecasts and various scenarios. This sort of approach might win you a prize in a visual design contest, it will not help you raise investment.

A business plan clarifies what a business is going to do, and how it is going to do it. For any start-up or established business, the process of writing a business plan is a discipline in explaining this. The article will therefore focus on what is required to produce an investor-grade business plan, what should go into the plan, and what investors or venture capital firms look for before they invest in a business.

Function and role

The business plan is a blueprint for a business; it is essential if you are thinking of starting a business and is also an important tool for any established business. It is not static; rather, the business plan for any business will change over time as the business develops and as objectives change. For any start-up business, here are strong reasons why you need to write one:

- the process of writing a business plan will challenge owners to critically examine the business potential. It will test and serves to clarify the feasibility of the business idea;
- it allows you to set out your goals and prioritise business objectives;
- it allows you to measure what progress is achieved; and
- it is required to attract investors and secure funding.

Contents

In terms of length, an investor-grade business plan of 10-20 pages is reasonable. The key elements and content should include the following:

1. Executive summary: the most important part of the business plan, the executive summary is generally the last section to be written. The objective is to grab the reader's attention, sell the investment opportunity, and to get the potential investor to read the entire plan. It should be succinct and no longer than two pages. The key elements are:

- **Opportunity**: in a nutshell why is your product great and what customer problem will you solve? Explain the pain-point, your solution, and what are you offering.
- **Product**: describe its benefits and what it can deliver.
- **Value proposition**: who is the target market, your customer, and why will they want to buy it? What are the benefits?
- **Marketing strategy**: how will you reach your customers and what are your distribution channels?
- **Competitive advantage**: who is the competition? What is your competitive advantage?
- **Business model**: how will you generate revenue, and from whom? Why is your model scalable?
- **Team**: who are the management team, and why will they succeed?
- **Financials**: include highlights from the P&L for the next three years, cash balances, and headcount. Explain how you will reach your revenue targets.
- **Funding**: how much funding is required, and what will it be used for? Outline plans for future funding rounds.

2. Product/service solution: what is it, what does it do, how does it work, who is the typical customer, and why is it different?

3. Value proposition: explain the problem your business aims to solve. Where is the pain? Quantify the benefits for your customer in terms of money or time – and remember, the pain must be large and the benefits meaningful to convince a customer. Skip the technical jargon and be customer-centric.

4. Market and opportunity: explain the overall industry and market dynamics. Segment the market by customer group and identify your target customer. Quantify the total market size and market opportunity of your addressable market. Use charts or graphs if necessary but remember that all figures should be from accredited sources and referenced.

5. Competition: list and discuss all your competitors. Include any product/service that could be a substitute or alternative for your customer and outline how you compare with competitors.

6. Competitive advantage/edge: some call this the secret sauce. How are you differentiated from your competitors? Detail your sustainable competitive advantage, highlight any barriers to entry that might keep your competitors away, and explain why any customer would buy your product/solution.

7. Business model: how will you make money, who pays you, and how much do you keep after any expenses? Explain all sources of revenue from your customers and explain how your model is scalable.

8. Marketing/sales strategy: this is your 'go to market' strategy. How will you reach your customers? Will you choose direct sales, partners, resellers or web? Include pricing and how much will go to channel intermediaries; provide a timeline of key milestones.

9. The team: detail founders and key members, their qualifications, experience, track record, and domain knowledge. Include any advisory board members or industry figures involved with the business.

10. Financial projection: for a start-up, include one-year detailed P&L data, cash flow prediction, balance sheet by month, and annual summary figures for three years thereafter highlighting key figures in P&L, cash flow and headcount. Also, what and when is your peak cash requirement? Cash is critical, and the cash flow statement is the key one. For an established business, include P&L, balance sheet for the last three years, and project P&L, cash flow and balance sheet by month for the next three years. For any financial projection, outline all key assumptions used. These must be based on sober and pragmatic reasoning, clearly justify growth assumptions, and highlight the peak cash requirement and break-even point.

11. Funding requirements: explain the amount of funding required for the business. How much is being provided by other investors? State what the funds will be used for and show how much existing founders and owners have provided to date.

12. Exit strategy: discuss the opportunities for investors to exit such as an acquisition, trade sale or IPO (beware, IPOs are only for the very best companies). Highlight trends in the market and give examples of valuations relevant to your business, but don't go overboard and perhaps discuss your aim to build a truly sustainable business.

Business plan pitfalls

Do not make exaggerated claims. Business plans are meant to inform and reassure, not entertain, readers. Avoid the following types of statements or claims unless you can back them up with robust evidence:

- according to Gartner, the market is worth X billion; we only need Y% of this.
- we have no competition.
- our product is vastly better than anything else available.

- we can be number two in the market within 12 months.
- our technology is superior.
- customers will switch to our product.
- we will be profitable within 12 months.
- we can repay our investors after three years.
- our mission-critical kit is best of breed.
- we plan to target multiple overseas markets.
- we need to pay top salaries to attract top people.
- we want to retain the maximum amount of equity possible.

It generally takes at least four years to reach €1 million in annual turnover, and that is if you are exceptionally lucky. It generally costs twice as much and takes you at least twice as long as you think it will to get there.

Raising finance

A start-up will typically go through different stages of funding sources as it moves from idea stage to product development, testing, initial customer validation and on to generating revenue. Initial funding will be provided by the founder, family and friends. Sooner or later, the founders will need to seek seed funding, which might be provided by an angel investor or seed venture capital fund. When a business seeks to raise outside finance from an investor or venture capital firm, they will look for the following criteria:

1. **Team**: investors ultimately back people, not ideas. This is the number one criterion. They especially like those with deep knowledge and great experience; they will focus on track record and achievements.
2. **Market**: they will seek a large market opportunity and strong growth rate. If the market has barriers to entry, better again. It needs to be big to support the returns many venture capital firms seek.
3. **Sustainable competitive advantage**: a clear competitive advantage or unique selling point over others.
4. **Technology**: great technology is a fundamental requirement now.
5. **Scalability**: clear potential to grow in overseas markets.
6. **High gross margins**: this reduces the amount required for working capital.

Conclusion

Without a well-prepared and researched business plan, there is little chance of attracting outside funding. For a reader, the plan should be:

- credible
- plausible
- implementable
- investable

It goes without saying that the plan should be grammatically correct, with no spelling errors. It should also be page referenced with no mistakes in the financials and look professional overall.

John Convery is a business adviser to start-ups and small businesses. In the October issue, John will consider why so many start-ups fail, and how to improve the chance of success.

https://www.charteredaccountants.ie/Accountancy-Ireland/Home/AI-Articles/how-to-create-an-investor-grade-business-plan

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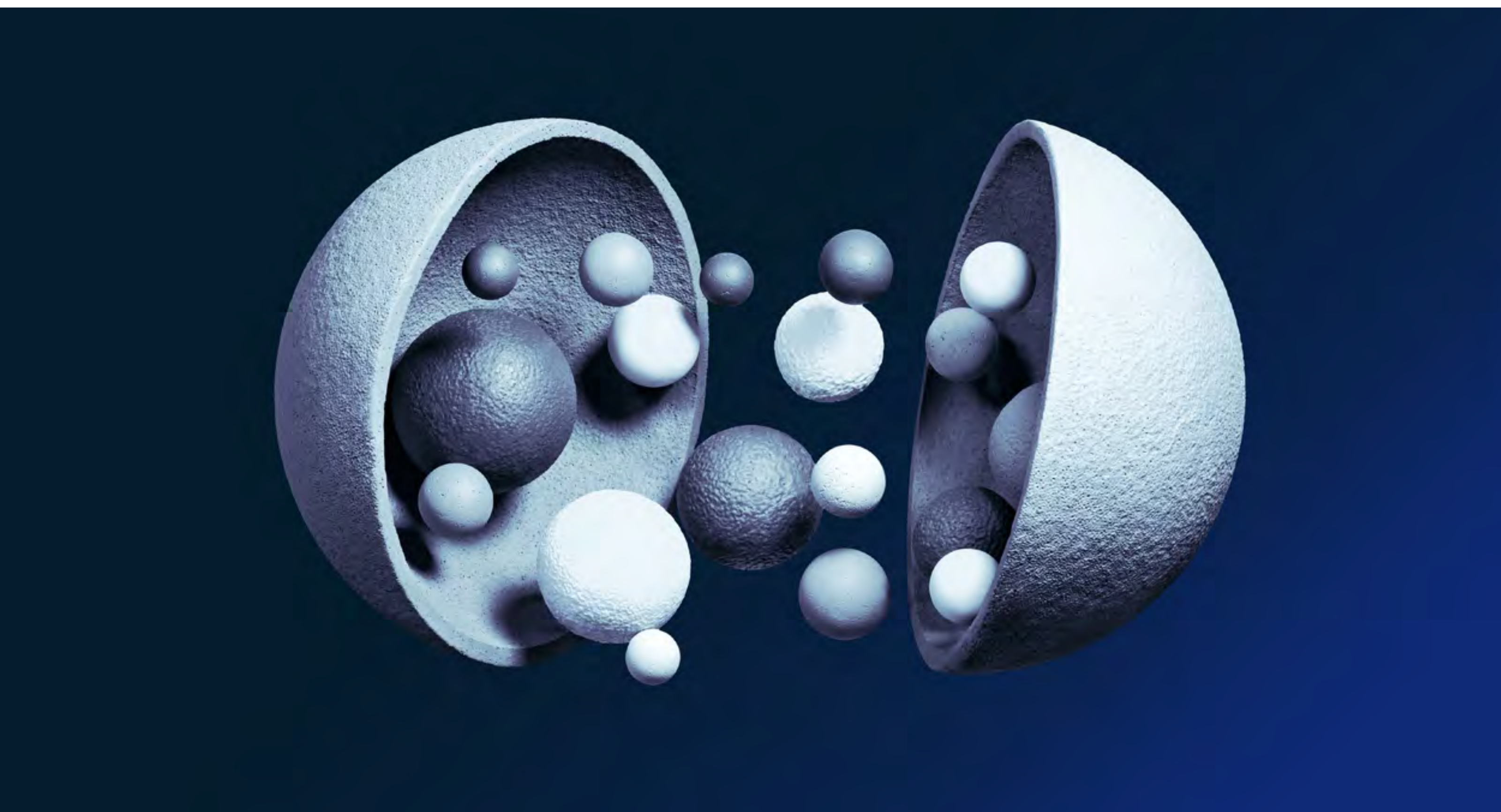
McKinsey & Company

Risk Practice

COVID-19 and the great reset: Briefing note #31, November 11, 2020

A vaccine breakthrough and how companies are thinking about purpose: here's the latest from McKinsey's research.



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November 2020

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This week saw some surprising news about a large COVID-19-vaccine trial: a leading candidate has an efficacy rate of about 90 percent. There's a lot of green between this particular ball and the pocket, but the news was most welcome. COVID-19 vaccines have been a focus of our research, as seen in our July 2020 overview, which includes a full discussion of the key issues of manufacturing and distribution, and subsequent articles on the end of the pandemic, an optimistic scenario for the pandemic response in the United States, and the technology transfer that may be critical to beating the COVID-19 crisis.

With the end in sight, or at least in fuzzy focus, companies are thinking ahead. A critical challenge for companies in the postcrisis era will be articulating clear, meaningful, and authentic purposes. Some companies seem to have the answer: they know their reasons for being, communicate them easily to customers, and enjoy the results. Our new framework (exhibit) can help others think through these knotty issues.

Exhibit

To embed purpose in your company and deliver value, follow the 5Ps.

1 Portfolio strategy and products

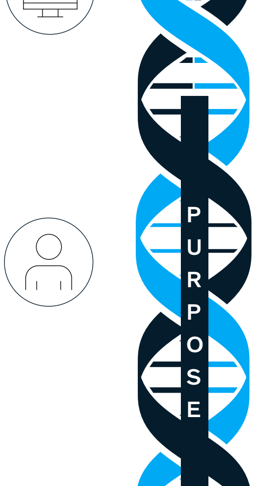
- Redefine product portfolio—eg, withdraw some products, introduce new products
- Revise pricing in line with purpose
- Review portfolio and test purposefulness of individual assets against common criteria

2 People and culture

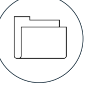
- Align recruiting, people development, and career pathways to enable purpose
- Define purpose KPIs and hold employees accountable/give them incentives to meet targets
- Articulate and role-model desired individual mindsets and behaviors linked to purpose

3 Processes and systems

- Adapt operational processes to meet purpose-related targets
- Ensure supplier behaviors are in line with purpose

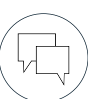


4 Performance metrics



- Set performance targets and metrics in line with purpose
- Introduce capital-allocation metrics in line with purpose for decisions (eg, capital expenditures, M&A)

5 Positions and engagements



- Tailor external engagement and communications to purpose
- Revise external positions in line with purpose
- Align affiliations (eg, trade-association membership) with purpose

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Many organizations are accelerating their cost-reduction targets, modifying their operating models on the fly, and redefining their functional priorities.

Governments have not lost sight of their purpose, but fulfilling it has become much more difficult. The gap between incoming and outgoing funds may reach $30 trillion soon. Our latest research shows a particularly effective bridge for governments to consider: real estate. The public controls a vast amount of acreage, office space, and other assets, and governments can extract much more revenue from them without breaching the public trust. On a related note, as part of their purpose, many businesses will embrace sustainability; voluntary carbon markets can help them reach their goals.

Cost management may be the yin to purpose's yang, but is no less essential. In our new survey of some 300 C-level executives, we look at the ways that the corporate center is evolving. Our latest observations find that many organizations are accelerating their cost-reduction targets, modifying their operating models on the fly, and redefining their functional priorities.

Our new regional research considers two large economies in Asia. China, the world's growth engine for the past 25 years, has come back—in ways that may surprise you. Consumer behavior has changed, pockets of growth are shifting, and leadership and management practices are in flux; businesses that manufacture and sell in China must be alive to the changes. And in Australia, businesses would be wise to understand today's more mindful consumers.

Finally, the *McKinsey Podcast* zeroed in this week on retail, where the talk was all about rapid revenue recovery. Say what? It's true: winners are recognizing the shifts in consumer behavior, adjusting their offerings, and rebuilding their businesses. Successful companies have five traits in common.

Executives everywhere are thinking about the potential for successful vaccines to deliver the next normal. Start with the McKinsey Download Hub to find McKinsey's latest research, perspectives, and insights on the management issues that matter most, from leading through the COVID-19 crisis to managing risk and digitizing operations. Also consider our special collection The Next Normal: The recovery Will Be Digital. The first two installments—a 172-page report on technology and data transformation and a 130-page report on the path to true transformation—are available now. Three more are coming as part of Our New Future, a multimedia series we created with CNBC.

You can also see the full collection of our coronavirus-related content, visual insights from our "chart of the day," a curated collection of our first 100 articles related to the coronavirus, our suite of tools to help leaders respond to the pandemic, and how our editors choose images that help readers visualize the impact of an invisible threat.

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McKinsey & Company

Strategy & Corporate Finance Practice

The CFO's role in helping companies navigate the coronavirus crisis

Strong, steady leadership from the finance organization is critical for addressing immediate concerns about safety and survival, stabilizing the business in the near term, and positioning it for recovery.

by Ankur Agrawal, Kevin Carmody, Kevin Laczkowski, and Ishaan Seth

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March 2020

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The spread of the novel coronavirus has created a worldwide humanitarian and economic crisis. The events we are living through are in many ways unprecedented, with large-scale quarantines, border closings, school closings, and physical distancing. Governments and communities have been jolted into action to "flatten the curve."

Organizations, too, have needed to accelerate their actions to protect employees, customers, suppliers, and financial results. The challenges are many and varied: with some companies losing up to 75 percent of their revenues in a single quarter, cash isn't just king—it's now critical for survival. While always important, digital connectivity is now fundamental to the continuity of business operations, as remote work becomes the norm across much of the globe. The need for frequent, transparent communication with colleagues and investors has only ramped up in importance as business conditions, epidemiological forecasts, and rules of conduct change daily, if not hourly.

Amid all this uncertainty, the CFO can play a strong, central role, alongside executive peers, in stabilizing the business and positioning it to thrive when conditions improve. The CFO is the leader, after all, who day to day most directly contributes to a company's financial health and organizational resilience. Our experience in helping clients through both internal and external crises offers lessons about the actions that CFOs should take in the wake of the pandemic to put their companies on a sound financial footing and help reduce some of the fear and uncertainty. We share those lessons in this article, outlining the critical steps CFOs and finance organizations can take across three horizons: immediate safety and survival, near-term stabilization of the business in anticipation of "the next normal," and longer-term preparations for the company to make bold moves during recovery.[1] Our guidance is based partly on empirical research McKinsey has conducted on companies that outperformed competitors coming out of previous crisis points and recessions.[2]

Resolve and resilience: Addressing the immediate crisis

Economically, the COVID-19 crisis is most immediately one of liquidity and resulting financial stress. As the coronavirus has spread, thousands of companies have had to close their doors temporarily. Their supply chains have been disrupted. Consumers can no longer make many discretionary purchases. The finance leader's top priority, then, has to be optimizing cash reserves, as the magnitude and duration of the crisis remain unclear. Specifically, the CFO should focus on assessing the company's liquidity, launching a centralized cash war room, developing different scenarios based on potential paths of the virus's spread, and rolling out an internal and external communications plan.

Launch a cash war room

Most CFOs are already moving quickly to quantify their companies' cash on hand as well as any incremental capital they can access. Finance leaders will need to forecast cash collections associated with the latest sales projections. With many customers delaying payments, however, some companies may need to double down on collections to remain solvent. When working capital is no longer sufficient, CFOs should consider tapping lines of credit and other options while reviewing opportunities to raise capital, such as through divestitures or joint ventures. If necessary, they should also seek relief on debt covenants as early as possible to strengthen the balance sheet before doing so becomes a matter of survival. In such times of crisis, when a cash shortage is a distinct possibility and conditions are changing constantly, setting up a cash war room can help CFOs implement aggressive curbs on spending throughout the organization. Additionally, CFOs can use various tools or mechanisms—what some would call a "spend control tower"—to prioritize payments and impose clear reporting metrics that track liquidity in real time.

[1] For regularly updated articles on the business implications of the coronavirus pandemic and how organizations can respond, see McKinsey's collection, "Coronavirus: Leading through the crisis," on McKinsey.com.
[2] Martin Hirt, Kevin Laczkowski, and Mihir Mysore, "Bubbles pop, downturns stop," *McKinsey Quarterly*, May 2019, McKinsey.com.

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Develop scenarios

Amid this period of heightened uncertainty, finance and strategy teams will need to rely on a range of scenarios rather than on individual time-horizon–based frameworks.[3] The finance leader should develop a point of view about two or three integrated scenarios that encompass multiple eventualities—for instance, which paths might the pandemic take, and which geographies or industries are poised for faster recovery than others? The CFO should also articulate clear thresholds or trigger points that suggest what financial actions the company will take and when. The financial planning and analysis (FP&A) group is uniquely positioned to help in this regard, as it works closely with the business units and can help project the effects of the pandemic on various aspects of demand and supply. Rolling forecasts should incorporate both macroeconomic and company-specific data to identify major areas of EBITDA risk. The forecasts should also identify second-order impacts, such as geographical supply-chain disruption and employee dislocation, as well as likely sources of cash leakage and customer-liquidity projections.

Once all this is in place, the CFO should guide the creation of a framework that a small executive team can use to make business decisions (to rationalize projects, for example) and monitor conditions (for triggers that might cause various scenarios to unfold, for instance). The CFO will need to track in real time the effect that cash decisions are having on the company's ability to ride out the downturn and resume business operations once demand begins to bounce back.

Institute a communications plan

The CFO must take a lead role in the financial and strategic aspects of crisis management. As mentioned previously, the company's primary finance focus during this period will be on implementing a "cash culture"—that is, preserving cash and deploying it dynamically. The CFO must communicate this priority throughout the organization and help establish incentives to reinforce it so that all departments and business units understand "why this matters now" and what their specific role is in helping optimize cash.

It is equally critical to communicate proactively with boards of directors and investors. The message to both should focus on the crisis's actual and projected effects on the company, the actions being taken to protect the business, the liquidity situation, and any changes to earlier earnings commitments. In addition, the CFO would be wise to increase the frequency of investor communications after the first few months of upheaval, particularly when new information is available. Such connections are essential for demonstrating that executives are taking fast and resolute action based on their best understanding of the situation.[4]

The CFO should guide the creation of a framework that a small executive team can use to make business decisions and monitor conditions.

[3] "Economic Conditions Snapshot, March 2020: McKinsey Global Survey results," May 2020, McKinsey.com.
[4] For more on communicating with investors during this crisis, see Tom Kolaja and Tim Koller, "When investors call: How your business should talk about coronavirus," March 2020, McKinsey.com.

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Return: Stabilizing the business

Once concerns about cash preservation have been addressed, the CFO needs to ensure that the company is positioned to operate effectively in this next normal. The finance leader's critical tasks here will include making operational improvements to bolster productivity, reevaluating the investment portfolio, and investing in the finance function's capabilities.

Bolster productivity

Our research shows that, during the last economic crisis, a small subset of leading companies (we call them "resilients") pursued productivity improvements more often and more frequently than others, creating the capacity for growth during recovery.[5] As a result, they outperformed competitors, doubling their generation of TRS over the subsequent decade. What's more, when compared with peers, the resilient companies reduced their operating costs by three times as much—and they made the moves to do so 12 to 24 months earlier than peers did.

The CFO and the finance organization can make several operational moves to support near-term performance improvements. For instance, to shore up revenues, the CFO can promote the development of new products and services that will assist customers who are experiencing financial difficulties, thereby promoting loyalty from valuable customer cohorts. The CFO can actively reallocate resources to businesses with strong existing revenue streams and optimize the company's use of alternative sales and delivery channels, such as e-commerce.

With much of the world in lockdown and demand falling, it will be necessary for finance leaders to take decisive actions for reducing operating costs, but it will also be critical for CFOs to maintain some flexibility and to balance those reductions against the eventual need to scale operations back up as the economy recovers. In the meantime, the CFO and finance team can also bring some rigor to spending management by implementing rapid zero-based budgeting for all discretionary expenditures, such as indirect procurement.

Reevaluate investments and strengthen the balance sheet

CFOs should use this period of crisis as an opportunity to perform a deep diagnostic on the balance sheet—for instance, reviewing goodwill impairments; refinancing debt; reducing inventory, accounts-payable, and accounts-receivable terms; and so on. This sort of balance-sheet cleanup can extend the company's financial flexibility while keeping everyone focused on key metrics at a chaotic time. Additionally, CFOs should guide peer executives in a review of major R&D, IT, and capital allocations and use the opportunity to optimize the company's investment portfolio. It is very likely that business units' initial projected returns on investments will have changed significantly as a result of the pandemic. Finance leaders will need to quickly shift human and financial resources to higher-yielding projects and the initiatives most valuable to the company's future.

Turbocharge the role of financial planning and analysis

Under crisis conditions, the FP&A team must accelerate its budgeting and forecasting work, providing continually updated business information that the CFO and the finance organization can then incorporate into an integrated forecast. The FP&A team should use collaborative tools to monitor and manage key performance indicators; in a crisis period, issues with data latency will not be acceptable. And the team's updates need to become a true rolling forecast, supported by a "decision cockpit"—a real-time dashboard business leaders can use to focus on the seven to ten key metrics that will guide the organization's operations through the coming months.

Some finance organizations may lack executives with the skills necessary to elevate the FP&A team into such a role—those with analytics and business

[5] Martin Hirt, Kevin Laczkowski, and Mihir Mysore, "Bubbles pop, downturns stop," *McKinsey Quarterly*, May 2019, McKinsey.com.

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backgrounds may be in particularly short supply. To build up the finance bench, the CFO will need to scout for dynamic, proactive individuals; explicitly recognize their performance; and support their experiments with new tasks and new roles on the fly. Additionally, with the likely sudden and dramatic rates of unemployment in many sectors (such as hospitality and travel), finance organizations may be able to recruit top talent with some combination of the digital, finance, and business expertise required but that had previously been harder to find.

Reimagine and reform: Thriving in the next normal

Once the crisis abates, senior management will want to move forward. To enable the company's pursuit of bold strategic moves, the CFO and peer executives should convene a small group of talented executives whose mandate is to focus on strategic planning, with oversight and support from senior management and the board. The team will set the game plan for investments, portfolio shifts, and major productivity initiatives that will position the company to win after the pandemic.

There are five big moves that our research shows have the greatest impact on a company's ability to significantly outperform the market: dynamic resource reallocation, programmatic M&A, strong capital expenditure, productivity breakthroughs, and differentiation improvement.[6] All are important, but in the current crisis, reallocating resources for future growth, realigning the portfolio through acquisitions and divestitures, and boosting productivity are the most critical.

Adopt a transformation mindset when reallocating resources

Crises are often opportune times to restructure parts of the business that require transformation (and to take the related charges). This one is no different. The CFO and finance organization would be well served to adopt a transformation mindset when they are setting targets, managing performance, constructing budgets, or challenging their business on growth or expense actions. The finance team should launch a review of the portfolio, with a focus on achieving the full potential of each business unit. This is a time to shelve incremental thinking and seek out transformational plans that could boost revenues or reduce costs—not by 5 to 10 percent but by 30 to 40 percent.

Consider how M&A and divestitures could improve the portfolio

Roiled markets and plummeting valuations can create a ripe environment for M&A. CFOs should be a leading voice in determining how to use M&A as a tool to manage the crisis (through divestitures, for instance) and to reallocate capital toward high-priority needs (through product, geography, or supply-chain acquisitions, for instance). A programmatic approach to M&A—where companies pursue frequent small and medium-size acquisitions—may hold some promise during this disruptive period.[7] Consider that during the last financial crisis, companies that maintained a programmatic approach to M&A outperformed through the downturn and maintained excess TRS through the recovery. In fact, the top-performing companies through the downturn (those with top-quartile TRS) had the highest average volume of annual transactions during that time period and returned roughly six times that of the bottom-quartile performers. Similarly, resilient companies divested assets 1.5 times more than their nonresilient peers.

Boost productivity through digitization

This is the first economic disruption that requires a large part of the global workforce to perform their duties remotely, making digital-collaboration tools necessary to keep the business functioning. But the finance team's use of digitization to help the company manage the crisis should not be considered a onetime event. Digital initiatives that once seemed out of reach—from automated closings to real-time forecasts—are now business critical. The CFO and finance team should take a leadership position in advocating for the use of digitization across the organization, long after the

[6] Chris Bradley, Martin Hirt, and Sven Smit, "Strategy to beat the odds," *McKinsey Quarterly*, February 2018, McKinsey.com.
[7] Jeff Rudnicki, Kate Siegel, and Andy West, "How lots of small M&A deals add up to big value," *McKinsey Quarterly*, July 2019, McKinsey.com.

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crisis has passed. The CFO and finance team can codify the solutions they have developed—the cash war room, rolling forecasts, and collaborative dashboards, for instance—and help scale them throughout the organization. This active, informed embrace of digitization will be invaluable for ensuring accurate reporting, informed decision making, and business continuity in any future crises.

Meanwhile, much attention has been paid to the massive disruptions to global supply chains. These disruptions have changed business leaders' ROI calculus overnight—from being solely focused on efficiency to now accounting for resilience and stability. Consider how business-process-outsourcing centers worldwide are reeling from lockdowns and limited bandwidth in their own countries (India and the Philippines, for instance), and think about the degree to which many of the critical processes they support have been disrupted. CFOs will need to do the hard of work of digitizing and automating core business processes to reduce their exposure to exogenous shocks and to create resilience.

In the coming days, weeks, and months, as employees are struggling with anxiety about their health, their future, and their loved ones, finance leaders must demonstrate empathy—but also bounded optimism that the organization and its people will find a way through the crisis.

The CFO can back up this view with clear actions and decisions. Regular communication is critical: the CFO must be forthcoming about the "knowns" and the "unknowns." This will help ease misgivings, decrease distraction, and keep people motivated. Also critical is empowering others in the finance organization to direct aspects of the crisis response while establishing a financial decision-making framework that will help executive peers make necessary trade-offs.

No one knows how long the pandemic will last, but in time, business and daily life will find a new equilibrium. CFOs are key to ensuring that their organizations not only survive the current crisis but thrive in the next normal.

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The authors wish to thank Priyanka Chandanassery Prakash, Patrick McCurdy, Jonathan Slonim, and Marc Tellier for their contributions to this article.

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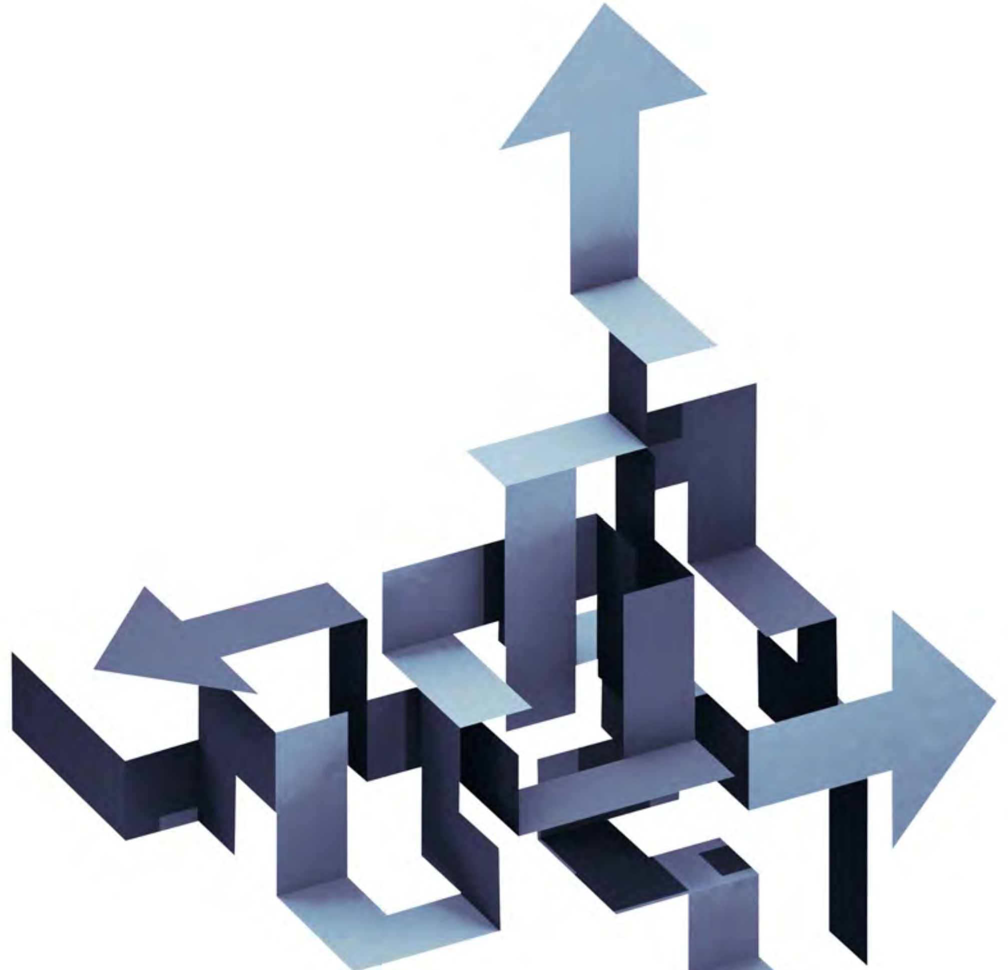
Strategy & Corporate Finance Practice

Planning for uncertainty: Performance management under COVID-19

Companies need a new approach to financial planning and performance management—one that informs rapid realignment of plans and actions and ensures organizational resilience.

by Ankur Agrawal, Kapil Chandra, Matthew Maloney, and Michele Tam



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Planning has never been a particularly easy task, but the spread of COVID-19 has made it even more difficult. Finance professionals are used to accuracy, consistency, and relatively predictable planning cycles, not the unclear economic conditions and time horizons of a global pandemic. As one executive told us: "The five-year plan that we would be sending to the board right now is completely out the window. How do we plan in this environment when we don't know what is going to happen?"

Clearly, companies' existing plans and assumptions will need to be revised in light of the rapidly changing global health situation, which is creating uneven economic effects across all industries (exhibit).

In normal times, financial-planning teams generally use a range of driver-based models for budgeting, forecasting, and root-cause analysis. Over the years, they have likely cultivated their own standard reports and preferred views of information. Few

Exhibit

The economic impact of COVID-19 varies by industry and sector.

Preliminary views of hardest-hit sectors (as of April 3, 2020)

Sector	Average stock-price change,[1] %	Industry-specific context
Commercial aerospace	–46	Preexisting conditions, challenges with airlines' balance-sheet resilience, and high fixed costs cause **near-term cash-flow issues and uncertainty about long-term growth.** It may take years to recover from production and supply-chain stoppages: critical vendors are in areas affected by the virus, and tier-3 suppliers are particularly susceptible to liquidity challenges.
Air and travel	–44	There is an immediate effect on demand, some 5 or 6 times greater than that of Sept 11, 2001; about 70–80% **near-term demand erosion** is due to international travel bans and quarantines. Bookings for summer travel season in the northern hemisphere are being affected by the public's fears about the duration of the virus. Faster recovery expected for **domestic travel** (about 2 or 3 quarters); slower recovery for **long-haul and international travel** (6+ quarters).
Oil and gas	–42	**Steep drop in oil prices** is driven by the virus's impact on short-term demand as well as the surplus resulting from OPEC+ decision to increase production. **Oversupply expected to remain in the market even after demand recovers**, and post-2020, unless OPEC+ decides to cut production.
Automotive	–29	**Existing vulnerabilities** (such as trade tensions, declining sales) **are amplified by acute decline in global demand**; Mar 26 survey of US auto consumers indicates 70% are deferring purchases by about 6 months or no longer intend to purchase. Despite ongoing Chinese economic restart, there is **continued supply-chain and production disruption** as majority of EU and US OEMs have temporarily closed plants and Hubei manufacturing remains at about 50% capacity.
Insurance carriers	–29	**Reduced interest rates** and investment performance are **affecting returns—especially for longer-tail lines**. **Disruptions are expected in new business and underwriting processes** due to dependence on paper applications and medical underwriting.

[1] In the past 30 days, for selected sector indexes.

Source: IHS Market; press reports; S&CF Insights; S&P Capital IQ; Corporate Performance Analytics by McKinsey; McKinsey Global Institute analysis

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have probably encountered the degrees of uncertainty they're experiencing now or been asked to conjure up a crystal ball in a matter of days to make the most important decisions their companies have ever faced.

Financial planning and performance management under this unprecedented period of turmoil requires a new, systematic approach, one that will allow the CFO and finance team to quickly alert the company to options emerging as a result of the coronavirus.

Specifically, the financial-planning team should focus on the following five steps: get a clear view of the company's starting position; build a fact base and use it to develop a range of scenarios; align on a financial plan with the "direction of travel"; determine best actions and moves; and, finally, identify the "trigger points" that will prompt the business to adjust and adapt forecasts and financial plans with alacrity.

In this period of pandemic, companies are at wildly different levels of liquidity and risk tolerance. Regardless of their starting points, all of them can use all or various aspects of this five-step planning process to cut through the uncertainty and make the best possible decisions.

The financial-planning team's primary responsibility is to help guide the organization through the worst of the crisis—as opposed to the mandate for the plan-ahead team, which is to look beyond the day-to-day of the crisis and develop a view of how the future may unfold. Once the worst has passed, however, there is also an opportunity for the CFO and the finance team to use the crisis as a starting point for deep discussions with business-unit leaders about how the overall planning process may need to change in the next normal.

Get a clear view of the company's starting position

The company needs a clear view of its starting position in the wake of the pandemic. To get this, it should convene a COVID-19 financial-planning team, supported by a range of cross-functional experts (for instance, in sales and in supply chains). Together, the financial-planning team and cross-functional experts can build a solid fact base, one that tells a comprehensive story about historical and current market and financial trends, as well as potential future indicators. The financial plan that the company rolled out in January 2020 can be a good anchor point for this exercise, as it can help to establish any assumptions that will need to change as a result of the pandemic.

The team should build a driver-based model from revenue to cash, looking monthly (or weekly if liquidity is at stake). It should compare the latest trends and the key operational drivers of the business (those inputs that have the most impact) prior to the crisis with the key drivers of the business since the crisis started. What has changed? What specific liquidity risks have emerged? How sensitive are these drivers to current uncertainties in the market? It is also important to look at business drivers within the industry (vendors, customers, and geographies) and how those have changed pre- and postpandemic. The outcome from all this will be a baseline set of facts to compare against emerging scenarios. These scenarios will become the new "true north" for the financial-planning team and the anchor points of the financial plan for the next 18 months.

Develop a range of scenarios

With a reliable fact base in hand, the financial-planning team should be able to quickly model three or four scenarios for how the pandemic might play out within its industry: a best case (optimistic), a worst case (pessimistic), a momentum case (continue on the current trajectory), and a most-likely case. In this way, the team can ensure that a breadth of outcomes are being explored; the organization cannot simply pick the middle scenario as the most likely case.

Each scenario must be assessed along three dimensions: depth of the decline, duration of the decline, and the time required to ramp back up. Each scenario must also accurately reflect the company's starting point: A company experiencing a slight decline in sales as a result of COVID-19 (grocery, for example) may only need to plan for small, nonstructural changes to ensure that it successfully weathers the

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The financial-planning team may want to revisit performance plans—emphasizing the implementation of initiatives rather than aggregated financial results.

crisis. By contrast, a company that has lost half of its sales as a result of the pandemic (hospitality, for instance) may need to plan for a revamp of its entire cost structure and even its entire business model. Hence the "best" and "worst" cases will look different for different companies, even in the same industry.

The financial-planning team should build financial forecasts that exclude any investments or upside from any strategic initiatives—essentially, the momentum cases for each scenario. The team should then stress-test forecasts and initial business assumptions against its scenarios. It will need to take time horizons into account—looking three months out, initially, but eventually extending that to 12 to 18 months. Throughout this modeling exercise, it is important for the financial-planning team to use conservative estimates and assumptions without trying to be overly precise.

It can then build a view of capital and capacity constraints due to COVID-19: Given near-term and midterm considerations, which strategic initiatives might be accelerated, slowed, deferred, or canceled outright? A company in a strong cash position may accelerate opportunities to shore up its supply chain—buying more raw materials or making advance payments to ensure access to resources. By contrast, a company facing liquidity issues may need to pursue the extension of payment terms with suppliers and defer some initiatives until the crisis abates.

Establish the 'direction of travel'

Once the fact base and scenarios have been created and pressure-tested, the financial-planning team, with input from the executive leadership team, will need to decide which scenarios make the most sense to pursue and then build a detailed financial plan around them.

Depending on the level of disruption the company faces, the direction of travel might focus on sustaining the existing business and restoring operations as quickly as possible, or restructuring the company to match the changing demand environment, or shifting the business model to meet radically different customer behaviors, or shaping a whole new business.

In all these cases, the financial-planning team will need to clarify the company's cash-conservation approach in a COVID-19 world, including a near- and midterm evaluation of cash flow. This approach should be applied and communicated to each functional and geographic area; everyone should understand what will be spent on operations, sales, marketing, and other critical areas. The emphasis, in times of immediate crisis, should be on what will maximize cash flow to sustain the company, not on overall company size or revenues.

Internally, the financial-planning team may also want to revisit performance plans—emphasizing the implementation of initiatives rather than aggregated financial results. This may be necessary for two reasons: first, previous compensation rewards may

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be linked to targets that no longer apply given the economic effects of COVID-19. And second, the context has changed so dramatically that any new initiatives may require employees to take on a completely different mindset and embrace new activities—for instance, asking a brewer to shift production resources from a traditional task (making beer) toward a new COVID-19-related one (using runoff alcohol to make hand sanitizer). It may also be necessary to consult tax experts given the degree to which the public-policy landscape and stimulus bills may vary by industry and geography.

Determine best actions and moves

With scenarios in hand and a direction of travel agreed upon, the financial-planning team must work with senior leadership to identify a coherent set of initiatives, determine how to execute on them, and track their performance across multiple time horizons. They will need to find the right combination of no-regrets moves, big bets, and real options. Typically, such moves will fall into one of three categories: initiatives that were built into the financial plan as of January 2020, initiatives that had been considered during the planning process but that were not included in the financial plan, and initiatives that may be required now as a result of the crisis.

Based on the financial-planning team's mapping scenarios, for instance, leaders at a midsize industrial company decided to shift resources away from those products that had seen a radical drop in sales due to the spread of the virus and toward products that were holding steady. The company also decided to invest in the conversion of some production lines so it could make personal protective equipment, urgently needed during the pandemic.

Meanwhile, senior leaders at a retail company that was in distress worked with the financial-planning team to build a list of priority initiatives and to map all potential levers required to carry them out successfully—cost, working capital, capital expenditures, and so on. It performed a deep-dive analysis of the products and services associated with these initiatives, as well as sales expected in the near and long term, to ensure that resources and priorities could be appropriately lined up. With this information in hand, senior leaders revised their list of priorities, deferring several initiatives and cancelling a few initiatives outright.

Identify 'trigger points'

Particularly in times of crisis, the financial-planning team must closely monitor the company's liquidity and earnings performance and any changes in the market. In our experience, senior leaders can fall into the trap of wanting to track multiple key performance indicators (KPIs) when only about ten variables matter. The financial-planning team should formally identify the most relevant indicators (or "trigger points") among all the business and operational drivers reviewed throughout the process. For many, this will include cash and sales figures but could also encompass customer-retention rates and sales-pipeline metrics. At one grocery retailer, for instance, it was critical to monitor inventory to avoid stock-out situations.

The team can then build a dashboard, which can be reviewed daily by the financial team and monitored for what has changed and any interventions required as a result of these changes—whether that means pulling different levers to achieve desired outcomes or modeling new scenarios. Initially, the dashboards created by the financial-planning team are likely to be "bootstrapped" using Excel and other common software. Ideally, they would be updated as often as possible to ensure that decision makers are receiving the most up-to-date, most reliable information.

In addition, the financial-planning team should identify those KPIs that would signal that the company is moving out of the crisis phase and entering the next normal; McKinsey research shows that companies' early recovery from downturns usually results in outsize gains in the market.[1]

Institutionalize new ways of working

By following the approach outlined in this article, financial-planning teams will inevitably begin to establish a range of new capabilities within the

[1] Martin Hirt, Kevin Laczkowski, Mihir Mysore, "Bubbles pop, downturns stop," May 2019, McKinsey.com.

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finance function—for instance, rapid planning and forecasting; cross-functional collaborations; and dynamic dashboards, KPIs, and triggers. In the next normal, companies should consider ways to build on these capabilities and embed them into day-to-day forecasting and performance-management processes.

They may want to shift permanently to shorter planning cycles, more frequent review of KPIs, or the use of zero-based budgeting models. The types of dashboards, nerve centers, and spend-control towers being developed to track finances during COVID-19 could be repurposed postcrisis to vault the company into its period of recovery. Finance organizations could further empower members of the financial-planning and analysis (FP&A) team to act as "sentinels" for recovery and resilience (see sidebar, "Playing catch-up: Bolstering FP&A capabilities").

For those finance functions and FP&A teams that have not explored automation and other time-saving technologies, the crisis may be a jumping off point to do so—freeing up members of the financial-planning team to serve as strategy partners and value managers rather than report generators.

COVID-19 is a global public-health crisis with tragic consequences. It does not have to be an economic disaster as well. Finance executives have a clear role in helping their companies through the pandemic with both a steady hand and a will to succeed. The times demand nothing less.

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The authors wish to thank Rodrigo Aparicio, Chris Bradley, Dago Diedrich, Frank Plaschke, Karolina Sauer-Sidor, Ishaan Seth, Jonathan D. Slonim, and Robert Uhlaner for their contributions to this article.

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Playing catch-up: Bolstering FP&A capabilities

The role of financial planning and analysis (FP&A) is heightened in times of crisis, but some companies are finding that—just when they really need them—they lack the accelerated analytics, business insights, and digitally driven solutions FP&A teams can provide.

In pursuit of various cost efficiencies, some companies have gradually reduced their investment in FP&A capabilities over the years and have inadvertently focused the function's efforts on arduous reporting and planning requirements instead of higher-order translation (from strategy to action) and analytical skills. During events such as COVID-19, these are exactly the types of skills required from FP&A—the ability to quickly clarify for business leaders the underlying drivers of the business; help them identify specific actions and initiatives required to manage through the immediate crisis; and, led by a focused plan-ahead team, anticipate actions for recovery.

There are several ways companies and FP&A organizations can begin to close this gap. In times of crisis, when the finance team is being pulled in many directions at once, the FP&A function should strive to convene agile teams of problem solvers to steer scarce analytical and strategic resources and capabilities to the priorities that matter. When financial acumen is in short supply, the FP&A team should reach out to others within the finance function who possess the relevant skills—and even to leaders in adjacent functions like operations and marketing who may themselves have spent time in FP&A. And given the uncertain labor market, this may be a good time for companies to look outside to find FP&A leaders with the required expertise.

There is no substitute, of course, for ongoing investment in FP&A capabilities. The companies that want to get it right should bump "FP&A talent development" up higher on the list of organizational priorities, and they should measure and monitor the function's progress in this regard. An intentional approach to bolstering FP&A capabilities is the only way to ensure that companies can generate the critical analyses and executive support they need, in both good times and bad.