Briefing Note for CLA members

Business Planning (9)

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In order to assist members during the agricultural transition, the CLA has produced a series of briefing notes on business planning. These provide information on what members need to consider when they are either developing their existing business or are considering a new business venture.

Financial analysis and planning

The financial analysis of the business plan needs to contain the data for financing the business now, what will be required for future growth and an estimation of operational costs and expenses.

As a result of the structured, in-depth financial data that will be required, it is important either to consult the business's accountant or seek independent financial advice before drafting this section.

Financial information needed for a business plan

The financial analysis section should include the following and be based on estimates for new businesses or recent data for established businesses:

- balance sheet – this should include the assumed and anticipated business financials, including assets, liabilities and equity;
- cash flow analysis – an overview of the cash the business anticipates will be coming in based on sales forecasts, minus the anticipated cash expenses for running the business;
- profit and loss analysis – the business income statement that subtracts the costs of the business from the earnings over a specified period, typically a quarter or per annum;
- break-even analysis – this demonstrates the point where the cost of running the business is fully covered by sales;
- personnel expense forecast – the expenses of the management of the business, as outlined in the management summary section of the business plan.

The financial analysis section of the business plan is often seen as challenging to complete. However, its importance cannot be overestimated and is often seen as the main section on which a potential investor will focus.

The following sections provide guidance on how to develop a clear and comprehensive financial analysis section for the business plan.

Assumptions

It is often said that it is better to anticipate rather than assume. For a new business, however, making assumptions is, in fact, a prerequisite. Without making assumptions as to the potential finances of the new business it will be impossible to establish, either for the business or the investor, whether the proposition is viable.

It is, therefore, useful to go back to other sections of the business plan to establish any financial assumptions that may have been made while drafting these sections. The most important factor, however, is to ensure that the data in the financial analysis section is consistent with the assumptions made in other sections of the business plan.

Financial planning, forecasting and risk analysis

The business plan needs to set out how the finances of the proposed business will be structured, forecasts for sales volume, cash flow and profit and loss as well as the potential risks the business is likely to face.

Financial planning

The business plan will need to provide a set of financial projections which translate what has been said about the business in numbers.

Attention should be drawn to:

- the amount of capital needed if external finance is required;
- the security that can be offered to lenders;
- how the business will repay any borrowings;
- sources of revenue and income.

Forecasting

The forecasts should cover three main periods: the first year; the first three years; and the first five years. In addition, the level of detail should reflect the actual complexity of the business. However, it is essential that the first 12-month forecast should include the most detail. The forecasts need to include:

- sales – the amount of money expected to be raised from sales;
- cash flow – the cash balance and monthly cash flow patterns for at least the first 12 to 18 months. The aim is to show that the business will have enough working capital to survive. This section also needs to consider other key factors such as the timing of sales and payment of salaries;
- profit and loss – a statement of the trading position of the business. It needs to show the level of profit that is expected to be made and the costs of providing goods and services as well as the overheads associated with the business.

In terms of sales forecasts, the following questions need to be answered:

- How soon can the business start selling?
- Will potential customers wait until they see the viability of the company before purchasing?
- How often will the business be able to sell?
- How many days can the business spend selling?
- How long will each sales opportunity take to follow up and produce?
- What percentage of opportunities will turn into sales?
- How much will the business be able to sell?
- What will be the average sale price?
- Will there be repeat customers or must the business find new customers on all occasions?
- How long will the payment process take?
- How much income can the business realistically expect each month?
- What level of margin on sales is forecast?

As importantly, the forecasts should cover a range of scenarios. New businesses often forecast over-optimistic sales and most external readers will take this into account. Therefore, it is sensible to include subsidiary forecasts based on sales being significantly lower than are being predicted. A good example is for a sales forecast starting three months later than anticipated and another forecasting a 20 percent lower level of sales.

Risk

It is good practice to show that the business plan has reviewed all the risks the business is likely, or potentially likely, to face. It needs to show that the business has looked at contingencies and insurance to cover the risks involved.

Such risks can include:

- competitor action and reaction;
- commercial issues such as sales, price and deliveries;
- operations including IT, technology or production failure;
- staff – skills, availability and costs;
- acts of God, including fire or flood.

External support

The financial analysis section in the business plan is likely to require more support than the others. The assumptions, forecasting and detailed financial information are likely to be complicated. It will be difficult to draft, especially if the person drafting this section does not have a financial background.

But this section of the business plan is fundamental to the success or otherwise of securing external investment and it will be the main section potential investors will analyse. Therefore,

serious consideration must be given to getting outside financial assistance to ensure that this section makes sense and adds up.

Knowing the general principles of accounting

When drafting the financial section of the business plan it is important to have a grasp of the basic principles of accountancy through the generally accepted accounting principles. This will help in knowing where the data comes from and what the figures mean. This will also help the business owner who will have to explain the financial data when presenting the business plan.

Visual aids

Graphs and charts should be used to illustrate the financial data, as is the case with other sections of the business plan. The most useful and important visuals should be put in the main body of the business plan with supporting graphics as an appendix.

Accurate calculations

The financial section must make sense and the figures must actually say what they are meant to say. One of the easiest ways to have a business plan rejected is if the financial data is not backed up or is simply wrong. Therefore, it is necessary to check all financial data a number of times as well as asking a third party to do the same.

It is also important to avoid including any figures that are either not explained or cannot be explained. This is particularly true with the assumptions that are made. Therefore, it is useful to use data from current and past markets and financial situations to substantiate the data put in the business plan.

Questions to consider

To ensure that the financial section of the business plan has covered all eventualities, the following broad questions need to be answered:

- What initial investment will the business require?
- How much control are the business owners willing to relinquish to investors?
- When will the business see a profit?
- When can investors expect a return on their investment?
- What are the projected profits of the business over time?
- Will the owners be able to afford to devote enough time to the business?
- What level of salary is anticipated?
- What are the chances of the business failing?
- What will happen if it does?

These more detailed financial questions also need to be answered:

- Has an estimate been made of the projected sales income from the business?
- Has an estimate been made of the direct and indirect costs of running the business, including contingency and survival funding?

- Has the business put together a cash flow projection for at least the first 12 to 18 months of the business?
- Has a reasonable and costed contingency fund been included in the financial forecast in case sales are significantly different than the forecast?
- Does the business know how much finance will be needed to fund the business and where the initial capital will come from – will the business be obtaining finance from the bank or external investors or from friends and family?
- Has the business considered in the financial forecasts the full cost of any borrowing, including repaying both capital and interest?
- Has the business identified assets which can be used as security to lenders, particularly banks?
- Has the business drafted a survival plan with sufficient cash flow to cover all eventualities?

Once these questions have been answered, it is important to establish the start-up costs of the business with a 25 percent financial contingency built in and compare these with the sales forecasts. If the costs exceed expected income return, the business will have to find different ways to sell more, reduce costs or find a different business model that is viable. It must never be assumed that a start-up will begin making a profit immediately so it is important to be able to know exactly how much funding is required before a suitable margin can be made.

For further information please contact:

Charles Trotman
Senior Business & Economics Adviser, Land Use
CLA, 16 Belgrave Square
London SW1X 8PQ

Tel: 020 7235 0511
Fax: 020 7235 4696
Email: charles.trotman@cla.org.uk
www.cla.org.uk