Business Plan

1. What is a Business Plan?
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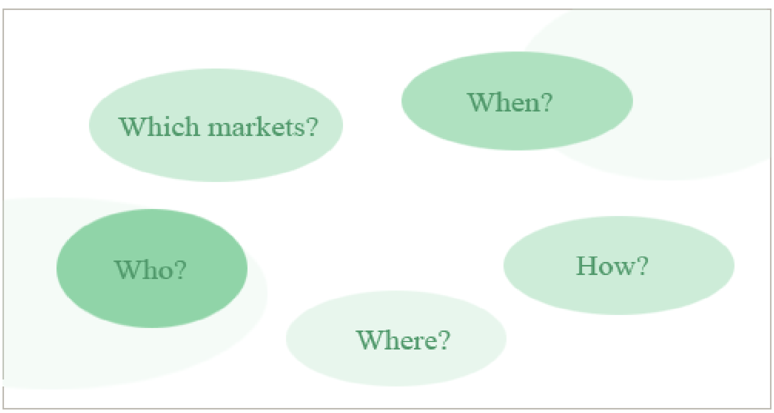
1. What is a Business Plan?

✓ A Business Plan is a document in which a business opportunity, or a business already under way, is identified, described and analyzed, examining its technical, economic and financial feasibility. The Plan develops all of the procedures and strategies necessary in order to convert the business opportunity into an actual business project.

✓ It is an indispensable tool in order to start up a business project, independently of the size of the project and/or of the amount of business experience of the entrepreneur.

✓ It provides an answer to simple questions about a new business or a business already under way:



2. What is the purpose of a Business Plan?

✓ The purpose of a Business Plan is to identify, describe and analyze a business opportunity and/or a business already under way, examining its technical, economic and financial feasibility.

✓ Moreover, it should serve as a business card for introducing the business to others: banks, investors, institutions, public bodies or any other agent involved, when it comes time to seek cooperation or financial support of any kind.

✓ A Business Plan has a dual function:

- Management Tool.
- Planning Tool.

Management Tool:

- Provides economic/financial projections.
- Enhances the monitoring and control of the business by following up the results obtained and analyzing management indicators.
- Introduces an analysis of the supply and demand.
- Reflects the commercial strategy and the marketing policy.
- Identifies the guidelines for the management of human resources.
- Analyzes the key factors of success and the risks of a business.

Planning Tool:

The company assumes and takes responsibility for the definition of its objectives:

- With results-oriented actions.
- Strict fulfillment of its economic commitments.
- Orients decision-making processes:
- Provides qualitative and quantitative information.
- Planning conforms to a homogeneous pattern.

3. Why prepare a Business Plan?

4. Content of a Business Plan

The development of a BUSINESS PLAN consists of the following elements, which provide answers to the main questions that can be raised by third parties:

ANALYSIS OF THE PRESENT SITUATION

⇨ What is the sector like? What is the present situation of the sector and the future outlook?

⇨ Who are the competition in the sector in which the company participates and what is the degree of rivalry among competitors? Who are the potential competitors?

⇨ What are the main factors that determine the success or failure of a competitor in the sector?

⇨ In what way is our business different from the business of our competition?

⇨ Identify weaknesses, threats, strengths and opportunities of the business.

⇨ Is there a target market for this business?

BUSINESS PLAN OBJECTIVES

⇨ What are the reasons for investing in this business?

⇨ What does my business consist of? What are the goods or services that I am going to offer?

⇨ What strategy am I going to follow in order to maintain a competitive advantage over time; specialization, differentiation or competition in costs?

⇨ What areas or processes are critical for the development of the business? What areas are supports for the critical processes of the business?

⇨ What are my perspectives on the evolution of the business?

STRATEGIC PLAN

⇨ What is the mission of my company?

⇨ How are the strategic lines of my project going to unfold as long-term objectives?

⇨ Have specific action plans been defined for achieving the long-term objectives? Have resources been allocated to such plans?

⇨ How is my marketing policy structured? Have I considered the price, location, product, promotional aspects?

⇨ How many employees comprise my staff? And what are my personnel management policies?

⇨ Have I planned for the financial needs that could arise in the long term?

5.Financial Plan

⇨ The purpose is to analyze the profitability and economic feasibility of the business project.

⇨ This analysis is the quantification of the strategy defined by the entrepreneur and will enable him or her to analyze the economic impact of the decision making.

⇨ A full analysis includes a projection for the time horizon considered in the Business Plan.

- Income and Expenditure Projections
- Investment Budget and Depreciation Schedule
- Profit and Loss Account
- Borrowing Requirements
- Balance Sheet
- Cash Flow
- Net Present Value

INCOME PROJECTION

✓ The step prior to drawing up the Profit and Loss Account is to project the income and expenditure on the time horizon considered in the Business Plan.

✓An income projection is made for each product line or business line, if such lines exist. For each item of income, the most appropriate variable for an accurate projection is taken: sales volume, growth of the potential market, market share, etc.. The revenues will be imputed to the relevant product or business line.

Unit price per product line:	Year 0	Year 1	Year2
P1	35	35	35
P2	45	45	45
P3	0	0	0
Unit quantity per product line:	**Year 0**	**Year 1**	**Year2**
Q1	3.650	4.380	5.475
Q2	2.850	3.420	4.275
Q3	0	0	0
Operating Income:	**Year 0**	**Year 1**	**Year2**
Product Line 1	127.750	153.300	191.625
Product Line 2	128.250	153.900	192.375
Product Line 3	0	0	0
Total Sales	256.000	307.200	384.000

EXPENDITURE PROJECTION

✓For the projection of expenses, an analysis is made of the items that make up each expenditure account used, estimating what their future trend is likely to be, and finally moving on to their quantification, both economic as well as in the expense unit itself (number of people, computers, etc.).

For example, in order to project the financing charges, we must take the total amount of the debt owed to third parties and apply to it the interest rate estimated for the financial years being analyzed.

	Year0	Year 1	Year 2
No. People	3	3	3
Mean salary cost	24.000	24.000	24.000

	Year0	Year 1	Year 2
Cost of Direct manpower	72.000	72.000	72.000

INVESTMENT BUDGET

✓The expenditure is the flow of resources that is consumed in obtaining the product or service supplied or provided by the company. In contrast to investment, it is the application of financial resources to be used to increase the fixed or financial assets, in exchange for the expectation of obtaining future profits.

Example: machinery, equipment, public works, bonds, certificates, securities, etc.

DEPRECIATION SCHEDULE

✓Depreciation is the depreciation or loss in value that investments in fixed assets undergo over time (equipment, machinery, etc.).

✓In order to offset the depreciation undergone by the property elements, the entrepreneur must create a depreciation fund. This fund grows each year in an amount equal to the loss in value undergone by the assets, in such a way that by the end of the economic life of the depreciable element, the entrepreneur will be able to replace that element by using the money accrued in the depreciation fund. This item in the accounts does not signify an outlay of cash, but rather is an expenditure item that involves reducing the profit for the year.

✓There are different fixed asset depreciation methods, in order to calculate the annual allotment for depreciation of each kind of asset: straight-line, accrual, etc.

✓ The straight-line depreciation method consists of keeping the depreciation allotments constant throughout the useful life of the element. A part of the depreciation value is assigned to each year.

✓An example for calculating the depreciation increments:

Investment in fixed assets increments	Year 0	Year 1	Year 2
Tangible fixed assets	6.300	6.300	6.300
Intangible fixed assets	8.700	8.700	8.700

Period in years of tangible fixed asset depreciation	8
Period in years of intangible fixed asset depreciation	5

Depreciation	Year 0	Year 1	Year 2
Tangible fixed asset depr. increments	788	788	788
Intangible fixed asset depr. increments	1.740	1.740	1.740
Total depreciation increments year	2.528	2.528	2.528

Tangible fixed assets Year 0 / Period in years of depreciation of tangible fixed assets

PROFIT AND LOSS ACCOUNT

✓The basis for the economic analysis is found in the analysis of the Profit and Loss Account. This analysis enables us to assess issues such as:

- Performance of the turnover.
- Trends in the gross margin.
- Trends in overhead and financing charges.

✓In the financial plan, the Profit and Loss Account is formed with the income projection, the expenditure projection and the depreciation schedule.

✓The Profit and Loss Account will also be broken down into the product or business lines, if these exist, both for the current year as well as for the future years that are being estimated.

✓The structure of the Profit and Loss Account is as follows:

Profit and Loss Account

Sales
- Product line 1
- Product line 2
- Product line3

Variable costs
- Raw materials or products
  - Product line 1
  - Product line 2
  - Product line3
- Direct manpower
- Other gen. costs (manufacture or service)

Gross margin

Fixed expenses
- Rentals
- Communications
- Transport
- Services by independent professionals
- Office supplies
- Repairs and upkeep
- Utilities
- Indirect manpower
- Taxes
- Depreciation
- Other expenses

EBIT

Financial charges
- **Short-term debt financing charges**
- **Long-term debt financing charges**

EBT

Taxes

Profit after taxes

BALANCE SHEET

✓The Balance Sheet reflects the company's net worth, which is made up by the property, rights, debts and capital which the company has at any given time.

✓An analysis of a company's balance sheet makes it possible to assess aspects such as: its liquidity situation or payment capacity, indebtedness (quantity and quality), etc.

✓A projection should be made of the balance sheet estimated for subsequent financial years, considering aspects such as the financing of the company in the short term (period less than one year) and in the long term (more than one year).

✓Thus, it will be possible to analyze not only what the company's position is at the present time, but also where it could be going in the future. The balance sheet is not static, but rather changes over time and therefore enables us to analyze the evolution of the different groups comprising the net worth.

✓The structure of the balance sheet is as follows:

Balance Sheet

Assets

Fixed assets
- Tangible fixed assets
- Intangible fixed assets
- Financial investments
- Start-up expenses

Current assets
- Stocks
- Accounts receivable
  - Customers
  - Government agencies
- Cash and banks

TOTAL ASSETS

Liabilities

Fixed liabilities
- Equity
- Long-term creditors
  - Long-term loan
  - Fixed assets suppliers
  - Long-term leasing creditors
  - Other long-term debits

Current liabilities
- Short-term creditors
  - Suppliers
  - Short-term leasing creditors
  - Short-term load
  - Government agencies
  - Other short-term debots

- Borrowing requirements

TOTAL LIABILITIES

BORROWING REQUIREMENTS

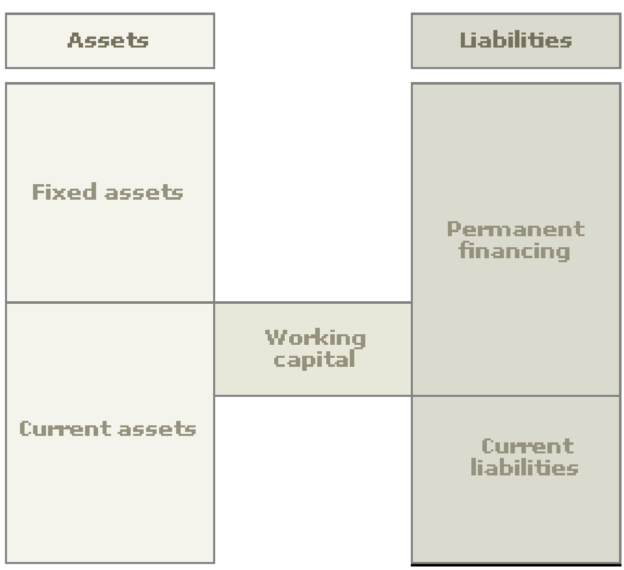
✓In order to implement their business plan, some entrepreneurs will have to turn to outside financing (in addition to the capital and the initial debt). In order to determine the level of borrowing necessary, it should be noted that the capital required in the company will vary to the extent the company moves ahead.

✓The volume of financial resources that a company is going to need depends on the investments in fixed and current assets as required each year.

✓The company will have reached a financial balance when the working capital is positive (as a general principle). The working capital refers to the part of the current assets that is financed with long-term debt, or as the amount by which the current assets exceed the current liabilities.

✓It is a financial guarantee of stability, because it means that the current assets are more than sufficient in order to attend to the short term debt (current liabilities). It is a kind of "cushion" that reflects the company's financial capacity in order to meet its short-term commitments.

✓The ideal Working Capital varies according to the sector and with a few exceptions should be a positive value, in order to avoid possible problems of liquidity.



CASH FLOW

✓ The Cash Flow measures the value of each business project through the amount of liquidity that it generates within a period of time, normally one year. It measures the company's capacity for generating funds through the activity it carries out.

✓ To sum up, the cash flow assesses the company's liquidity and its capacity to generate funds.

An analysis of the cash flow is an efficient aid in an entrepreneur's decision making, as it:

- Helps to ascertain whether the investment is financially possible for the entrepreneur, because he/she has the necessary resources.
- Makes an assessment of the liquidity that each project generates throughout its life.

✓ The structure of the cash flow is as follows:

Cash Flow
Net Result
(+) Depreciation
Cash Flow
(-) Investment in Working Capital
(-) Investment in Fixed Assets
Free Cash Flow

• The depreciation is subtracted on the profit and loss account because it is an expense represented by the loss in value undergone by the fixed assets, buildings, furnishings, etc.., through wear and tear and/or age, thus reducing the annual profit obtained by the entrepreneur.

• In order to calculate the cash flow, only the inflow and outflow of funds are taken into account; in this case the depreciation has not involved an outflow and thus the amount of depreciation must be added to the profit for the year, in order to calculate the flow generated by the project during the year.

• The working capital is defined as the difference between the current assets and the current liabilities. This is, the difference between the collectable short-term resources with a more or less immediate liquidity (customers, stocks, etc.) and the short-term liabilities (suppliers and short-term creditors).

NET PRESENT VALUE AND COST OF CAPITAL

What criteria do I use in order to make an investment decision?

✓When deciding to undertake business projects, you should make an assessment in order to learn whether they are economically and financially feasible. The general criterion used is the NPV (net present value), which calculates the difference between the collections and the payments made by the entrepreneur throughout the life of the project and considers all of them at the present time.

✓In order to bring together all of the monetary flows (difference between collections and payments), a discount rate has to be used, that is, the rate at which the monetary flows of the projects are discounted is the cost of capital, which is what, on an average, each monetary unit being used (financing through own and outside resources) is costing the entrepreneur.

How can I decide between two investment projects?

✓ The projects should have the same cost of capital. Once the assessment of the projects has been made, the rule of thumb is:

*To accept projects with NPV>0, as in this case investing the money in the project generates higher returns than putting it in the bank

*To reject projects with NPV<0,

*The recommendation is indifferent between accepting or rejecting projects with NPV=0

✓If the return generated by projects is greater than the cost, the rule is to go ahead; otherwise, they should be rejected.

Example for the calculation of the Net Present Value

✓A company has two possible investment projects; the return from each of the projects is going to be assessed by means of the NPV criterion.

✓ Project A involves an initial investment of 100,000 € and generates three years of cash flow (CF)

✓ Project B involves an initial investment of 100,000 € and generates two years of cash flow (CF)

✓ The Weighted Average Cost of Capital (WACC) is 5% for the two projects, as they have similar risks

	Initial Invest.	CF Year 1	CF Year 2	CF Year 3
Proyect A	100.000	20.000	25.000	65.000
Proyect B	100.000	55.000	55.000	

$$NPV = Initial\ Invest + \frac{FC1}{(1+r)} + \frac{FC2}{(1+r)} ... + \frac{FC}{(1+r)}$$

$$NPV_A = -100.000 + \frac{20.000}{(1+0.05)} + \frac{25.000}{(1+0.05)^2} + \frac{65.000}{(1+0.05)^3} \rightarrow NPV_A = -2.127,22$$

$$NPV_B = -100.000 + \frac{55.000}{(1+0.05)} + \frac{55.000}{(1+0.05)^2} \rightarrow NPV_B = 2.267,57$$

	PV Flow Yr1	PV Flow Yr2	PV Flow Yr3	NPV
Proyect A	19.047,61	22.675,73	56.149,44	-2.127,22
Proyect B	52.380,95	49.886,62		2267,57

✗ **Proyect A**

DON'T INVEST

NPV < 0

✓ **Proyect B**

INVEST

NPV > 0

6. What are the benefits to be derived from a Business Plan?

What are the benefits to be derived from a Business Plan?

- A written document helps the entrepreneur to clarify and understand his or her business project better.
- It focuses the resources on the attainment of the company's objectives and goals.
- A business plan is a passport to sources of finance
- It identifies the critical points of the business project and gives an response to the problems that could arise.
- It is a tool of communication in order to familiarize employees, sales staff, suppliers, etc.