

Financial Plans

The financial plan “tells the story” of your business in numbers.

The financial plan forces you to be confront certain matters:

- To appear credible and anchored in reality
- To be explicit about many matters
- To reconcile elements of your plan
- To determine your financing requirements
- To assess the economic viability of your idea

Entrepreneurship - Spring 2009

Major Elements of the Financial Plan

Narrative

- Summary of Projections
- Assumptions
- Breakeven Analysis
- Financing Requirements & Source/Uses
- Alternative Scenarios
- Risk Factors

Annual and Interim Period Projections – Five Years

- Income Statements
- Cash Flows
- Balance Sheets

Entrepreneurship - Spring 2009

Projected Income Statements

The “Profit” in Financial Plans

$$\text{Profit} = \text{Revenue less Expenses}$$

Entrepreneurship - Spring 2009

Revenue Projections

It All Starts with Revenue Projections

- In most worlds that breaks down to quantities and pricing
- The essential questions:
 - What are our revenue sources?
 - What is our pricing strategy?
 - What is the forecast (quantities) and the “ramp” look like?

Entrepreneurship - Spring 2009

Forecasting Demand

- Not easy to get right early on
- Don't make it dart throwing rather make it defensible and doable
- Some alternative approaches:
 - Proxy off of others and market-down based
 - Ground-up or with real revenue stream
 - A test – what can we do that is reasonable and plausible

Entrepreneurship - Spring 2009

Expense Projections

Expenses are the Other Part of Profit – such as

- Product/Service Costs (Direct)
- Other Operating Costs (Indirect)
- Development/Pre-operating Costs
- Sales and Marketing Costs
- Administration and General Costs

Entrepreneurship - Spring 2009

Expense Categories and Critical Inputs

Product/Service Costs

- Material, Labor, Product/service related overhead

Sales, Marketing and Distribution Costs

- Headcount/Hiring Plan and Compensation Rates
- Fulfillment Costs
- Marketing and Advertising programs

Expense Categories and Critical Inputs

Development Costs

- Headcount/Hiring Plan and Compensation Rates

Administrative and General Costs

- Headcount/Hiring Plan and Compensation Rates
- Facilities and Support Services (Acct, HR, etc.)

Taxes

- Tax rates, Unusual tax provisions

Other Important Financial Elements

Working Capital Requirements

- Accounts receivable
- Inventory
- Accounts payables

Capital Expenditures

- Equipment, Facilities, etc.

Financing Requirements

- Equity, Debt, Interest Cost

Other Possible Things in Your Financial Plans

- Breakeven
- Development/Pre-Operating Cycle
- Typical Sales Transaction
- Customer Acquisition
- Distribution Channels
- Selling Cycle

Entrepreneurship - Spring 2009

Last Words of Advice

Validate/Benchmark Your Projections

- Against peer product/business units/companies or by others
 - You will learn something
 - Makes your plan more defensible

Check for Consistency to the Rest of the Business Plan

Entrepreneurship - Spring 2009

Financing Your Ideas

You need to figure out to two things:

1. How much money do you need?
2. How do you fund/finance your new venture?

What types of financing are available?

What are the various sources of financing available?

Entrepreneurship - Spring 2009

The Hidden Costs of Other People's Money

Can dictate or compromise how you run the business

Less Flexible – can't try-it-and-fix-it

Some level of conflict may arise

Bootstrap Financing

What is bootstrap financing?

- **Two elements worth noting:**
 - **Sources of financing**
 - **Personal, Family and Friends**
 - **Limited opportunity for debt**
 - **Tactics**

Is Venture Capital a Good Fit?

Venture capitalists have specialized wants and tastes

Most start-ups are niche and knock off plays

Venture backed companies are asset plays

How Venture Capital Works

- VC fills a niche others do not address well
- VCs can add lots of value
- Must earn an acceptable return (25-35%+) at acceptable risk level

Entrepreneurship - Spring 2009

How Venture Capital Works

The deal must make sense

- Positioned to capture large upside potential
- Minimize/manage downside risk

Typical terms

- Series preferred stock based on milestones
- Term sheet will seem restrictive & controlling

Entrepreneurship - Spring 2009

Angel Investors

Individual private party investors:

- Large market, somewhat disorganized
- Invest their own money
- Motives and professionalism vary
- Tend to do smaller, more diverse deals
- Loosely banded groups, networks

Entrepreneurship - Spring 2009

Software Inc.
Projected Balance Sheets
As of December 31, 200X

	2002	2003	2004	2005	2006
Assets					
Current Assets					
Cash & Cash Equivalents	\$ 245,000	\$ 231,000	\$ 982,000	\$ 6,192,000	\$ 20,102,000
Accounts Receivable	312,000	640,000	2,451,000	4,894,000	9,947,000
Total Current Assets	<u>557,000</u>	<u>871,000</u>	<u>3,433,000</u>	<u>11,086,000</u>	<u>30,049,000</u>
Property & Equipment (net)	57,000	77,000	112,000	122,000	150,000
Other Assets					
Total Assets	<u><u>\$ 614,000</u></u>	<u><u>\$ 948,000</u></u>	<u><u>\$ 3,545,000</u></u>	<u><u>\$ 11,208,000</u></u>	<u><u>\$ 30,199,000</u></u>
Liabilities and Equity					
Current Liabilities					
Accrued Liabilities	<u>\$ 247,000</u>	<u>\$ 399,000</u>	<u>\$ 1,069,000</u>	<u>\$ 2,660,000</u>	<u>\$ 5,555,000</u>
Shareholders Equity					
Founders Common Stock	10,000	10,000	10,000	10,000	10,000
Investors Preferred Stock	1,000,000	2,000,000	2,000,000	2,000,000	2,000,000
Retained Earnings (Loss)	<u>(643,000)</u>	<u>(1,461,000)</u>	<u>466,000</u>	<u>6,538,000</u>	<u>22,634,000</u>
Total Equity	<u>367,000</u>	<u>549,000</u>	<u>2,476,000</u>	<u>8,548,000</u>	<u>24,644,000</u>
Total Liabilities and Equity	<u><u>\$ 614,000</u></u>	<u><u>\$ 948,000</u></u>	<u><u>\$ 3,545,000</u></u>	<u><u>\$ 11,208,000</u></u>	<u><u>\$ 30,199,000</u></u>

Software Inc.
Projected Income Statements and Changes in Retained Earnings
For Year Ending December 31, 200X

	2002	2003	2004	2005	2006
Revenue					
Sales Net	\$ 750,000	\$ 3,275,000	\$ 10,250,000	\$ 24,800,000	\$ 49,400,000
Total Revenue	<u>750,000</u>	<u>3,275,000</u>	<u>10,250,000</u>	<u>24,800,000</u>	<u>49,400,000</u>
Operating Expenses					
Cost of Goods and Services Sold	103,000	465,000	899,000	1,321,000	1,749,000
Selling and Marketing Expenses					
Marketing and Advertising	120,000	405,000	1,055,000	2,040,000	3,030,000
Salary and Benefits Expense	425,000	1,280,000	2,512,000	4,049,000	5,819,000
Commission Expense	120,000	459,000	1,230,000	2,480,000	4,940,000
General Administrative Expenses					
Salaries & Benefits	219,000	597,000	638,000	670,000	703,000
General Expenses	36,000	160,000	466,000	1,085,000	2,082,000
Development and Technical Service Costs					
Salaries & Benefits	370,000	727,000	1,307,000	2,155,000	3,084,000
Total Operating Expenses	<u>1,393,000</u>	<u>4,093,000</u>	<u>8,107,000</u>	<u>13,800,000</u>	<u>21,407,000</u>
Net Income Before Income Taxes	(643,000)	(818,000)	2,143,000	11,000,000	27,993,000
Less : Income Taxes	-	-	216,000	4,928,000	11,897,000
Net Income (Loss)	(643,000)	(818,000)	1,927,000	6,072,000	16,096,000
Beginning Retained Earnings	0	(643,000)	(1,461,000)	466,000	6,538,000
Ending Retained Earnings	<u>\$ (643,000)</u>	<u>\$ (1,461,000)</u>	<u>\$ 466,000</u>	<u>\$ 6,538,000</u>	<u>\$ 22,634,000</u>

Software Inc.
Projected Statement Cash Flow Statements
For Year Ending December 31, 200X

	2002	2003	2004	2005	2006
Cash Flow from Operating Activities					
Net Income	\$ (643,000)	\$ (818,000)	\$ 1,927,000	\$ 6,072,000	\$ 16,096,000
Depreciation	6,000	25,000	44,000	65,000	62,000
Changes in Working Capital Accts					
Accounts Receivable	(312,000)	(328,000)	(1,811,000)	(2,443,000)	(5,053,000)
Accrued Liabilities	247,000	152,000	670,000	1,591,000	2,895,000
Net Cash (used) provided by operating activities	<u>(702,000)</u>	<u>(969,000)</u>	<u>830,000</u>	<u>5,285,000</u>	<u>14,000,000</u>
Cash flows from Investing Activities					
Purchase of Equipment	<u>(63,000)</u>	<u>(45,000)</u>	<u>(79,000)</u>	<u>(75,000)</u>	<u>(90,000)</u>
Net Cash used by investing activities	<u>(63,000)</u>	<u>(45,000)</u>	<u>(79,000)</u>	<u>(75,000)</u>	<u>(90,000)</u>
Cash flows from Financing Activities					
Issuance of common stock	10,000	-	-	-	-
Issuance of preferred stock	1,000,000	1,000,000			
Net Cash provided by financing activities	<u>1,010,000</u>	<u>1,000,000</u>	<u>-</u>	<u>-</u>	<u>-</u>
Cash and cash equivalents at beginning of period	-	245,000	231,000	982,000	6,192,000
Cash and cash equivalents at end of period	<u><u>\$ 245,000</u></u>	<u><u>\$ 231,000</u></u>	<u><u>\$ 982,000</u></u>	<u><u>\$ 6,192,000</u></u>	<u><u>\$ 20,102,000</u></u>