

Helpful Hints

Financial Plan

Your financial plan should include:

1. A list of **Start-Up Costs** and how these will be paid for (eg from savings, bank loan or family loan)
2. A **Breakeven Analysis**, which includes:
 - a list of fixed costs (those costs which do not vary with the level of sales)
 - a list of variable costs (the costs of obtaining the goods for sale, or the direct costs involved in providing the service)
 - contribution margin (the amount which each sale contributes to covering the fixed costs)
 - breakeven point (the point at which all costs are covered but no profit or loss is made)
3. **Sales Budget** – the level of sales revenue for each month and the basis for the calculation (this would take into account the calculations of breakeven)
4. **Expense Budget** – the level of expenses per month (not including the set-up costs)
5. **Monthly Cash Flow Statement** for the year which will show:
 - the balance of the cash at the beginning of each month (this will include the set-up cash)
 - the balance of the cash at the end of the each month
 - payments for set-up costs
 - monthly cash drawn for the owner (a salary equivalent)
 - all cash flowing in during the month (from sales)
 - all cash paid for running expenses during the month



Helpful Hints

Case Study

The example included here for a financial plan is based on a shop selling CDs.

Example of Breakeven Analysis Calculation

Information regarding the costs of running the business must be assembled before a breakeven calculation can be made:

Fixed costs

These are costs which do not vary in total with the level of activity of the business. For example, wages, advertising, electricity (for lighting the shop), rent. These costs must be paid even if there are no customers and no sales.

For our case study, the total fixed costs will be \$80,000.

Variable Costs

These are the costs of buying the goods which are for sale (in this case, the cost of buying the CDs from the supplier), or the costs of providing the service (costs of providing a party organising service would be the cost of food, drinks, balloons and other decorations, presents). The total of the variable costs will rise with the level of activity – the more CDs which are sold, the higher will be the total variable cost.

For our music shop, the variable cost is \$5 per CD.

Expected selling price

How much do you think you can charge for your product or service?

Is the price higher or lower than competitors?

Do you think customers will be prepared to pay this price?

Our expected selling price is to be \$20 per CD.

Contribution margin

How much does each item sold contribute towards covering the fixed costs of the business? This is calculated by subtracting the variable cost from the expected selling price.

Our contribution margin is \$15 (\$20 minus \$5).



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Calculation for Breakeven Analysis

Formula for calculating Breakeven point:

$$\frac{\text{Total Fixed Costs}}{\text{Contribution Margin}} = \text{N}^{\circ} \text{ CDs}$$

eg

$$\frac{\$80,000}{\$15} = 5,333 \text{ CDs}$$

If the business is able to sell 5,333 CDs in a year, it will cover all costs, both fixed and variable, and no profit or loss will be made. To make a profit, more than 5,333 CDs will need to be sold. This business would like to make a profit of \$50,000 per year.

$$\frac{\text{Total Fixed Costs} + \text{Desired Profit}}{\text{Contribution Margin}} = \text{N}^{\circ} \text{ CDs}$$

eg

$$\frac{\$80,000 + \$50,000}{\$15} = 8,666 \text{ CDs}$$

If the business is able to sell 8,666 CDs in a year, it will make the desired profit of \$50,000. This represents 722 CDs per month.

Questions

- Is this possible?
- If not, what are the alternatives?
 - Find a cheaper supplier?
 - Increase the selling price?
 - Reduce the level of desired profit?



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Sales Budget

To prepare the sales budget, monthly or annual revenue must be calculated. If the business is to achieve the desired profit, 8,666 CDs need to be sold, at an expected price of \$20 each.

This will give total revenue of \$173,320 (\$14,440 per month).

A useful sales budget will be prepared on a monthly basis. This allows the owner to look at the pattern of sales for the year.

Questions

- Are there peak selling periods for this product Is this possible?
- Are there months when sales may be slow?

Expense Budget

The expense budget for the year must be prepared. We will spread the fixed costs across each month of the year. This however, will not be realistic. There will always be variations in what expenses are paid each month – eg the telephone account may only be paid every 2 months, the advertising may be mainly paid for in the first couple of months, with less for the rest of the year.

Cost of sales (variable costs)	8,666 x \$5 = \$43,330 (722 x \$5 = \$3,610 per month)
Rent	\$16,000 (\$1,333 per month)
Wages	\$15,000 (\$1,250 per month)
Electricity	\$2,000 (\$166 per month)
Motor vehicle costs	\$10,000 (\$833 per month)
Advertising	\$12,000 (\$1000 per month)
Miscellaneous costs (loan repayments, bank fees, repairs)	\$25,000 (\$2,083 per month)



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For the first month or two, there will also be set-up expenses which must be included. For this case study, we will assume that all set-up costs will be paid for in the first month of operation.

Setup Costs

Shop Fittings	\$35,000
Signage	\$4,000
Painting of Premises	\$8,000
Equipment (cash register etc)	\$50,000
Stationery	\$3,000
TOTAL SET UP COSTS	\$100,000

Cash Flow Statement

A cash flow statement must be prepared on a monthly basis. This is the only way in which the owner will be able to keep track of the cash position of the business. The balance of the cash at the beginning of the month must be shown, plus the cash flowing into the business during the month, and minus the cash flowing out during the month. The balance at the end of each month becomes the balance at the beginning of the next month.

Obviously the cash flow budget will be adjusted to take account of monthly variations in payment and receipts.



Helpful Hints

Cash Flow Statement

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec	Total
Cash inflows													
Set up capital													
Savings	20,000												20,000
Loan from bank	100,000												100,000
Loan from parents	30,000												30,000
Sales	14,440	14,440	14,440	14,440	14,440	14,440	14,440	14,440	14,440	14,440	14,440	14,440	173,280
Total cash inflows	164,440	14,440	14,440	14,440	14,440	14,440	14,440	14,440	14,440	14,440	14,440	14,440	323,280
Cash outflows													
Cost of CDs	3,610	3,610	3,610	3,610	3,610	3,610	3,610	3,610	3,610	3,610	3,610	3,610	43,320
Rent	1,333	1,333	1,333	1,333	1,333	1,333	1,333	1,333	1,333	1,333	1,333	1,333	15,996
Wages	1,250	1,250	1,250	1,250	1,250	1,250	1,250	1,250	1,250	1,250	1,250	1,250	15,000
Electricity	166	166	166	166	166	166	166	166	166	166	166	166	1,992
Motor vehicle costs	833	833	833	833	833	833	833	833	833	833	833	833	9,996
Advertising	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	12,000
Miscellaneous costs	2,083	2,083	2,083	2,083	2,083	2,083	2,083	2,083	2,083	2,083	2,083	2,083	24,996
Drawings (for owner)	4,166	4,166	4,166	4,166	4,166	4,166	4,166	4,166	4,166	4,166	4,166	4,166	49,992
Shop fittings	35,000												35,000
Signage	4,000												4,000
Painting	8,000												8,000
Equipment	50,000												50,000
Stationery	3,000												3,000
Total cash outflows	114,441	14,441	14,441	14,441	14,441	14,441	14,441	14,441	14,441	14,441	14,441	14,441	273,292
Excess of inflows over outflows	49,999	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	49,988
Balance at the beginning	-	49,999	49,998	49,997	49,996	49,996	49,996	49,996	49,996	49,996	49,996	49,996	-
Balance at the end	49,999	49,998	49,997	49,996	49,995	49,994	49,993	499,92	49,991	49,990	49,989	49,988	49,988

