COFOUNDER

ACE ADVISORS

# FINANCIAL PLANNING




PREPARED BY ACE ADVISORS & COFOUNDER

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# INTRODUCTION

The aim of this document is to provide a concise and practical high-level guide on financial planning, with a focus on the 3 questions:

1. **What?** Understand the definition of financial planning and break down its essential components.
2. **Why?** Underscore the importance of financial planning for startups.
3. **How?** Outline actionable steps that startups can take to incorporate robust financial planning strategies.

By providing tangible guidance, we aim to empower businesses to navigate their financial landscape effectively.



# What is Financial Planning?

Financial planning is the **process of determining your business's financial goals and needs** .

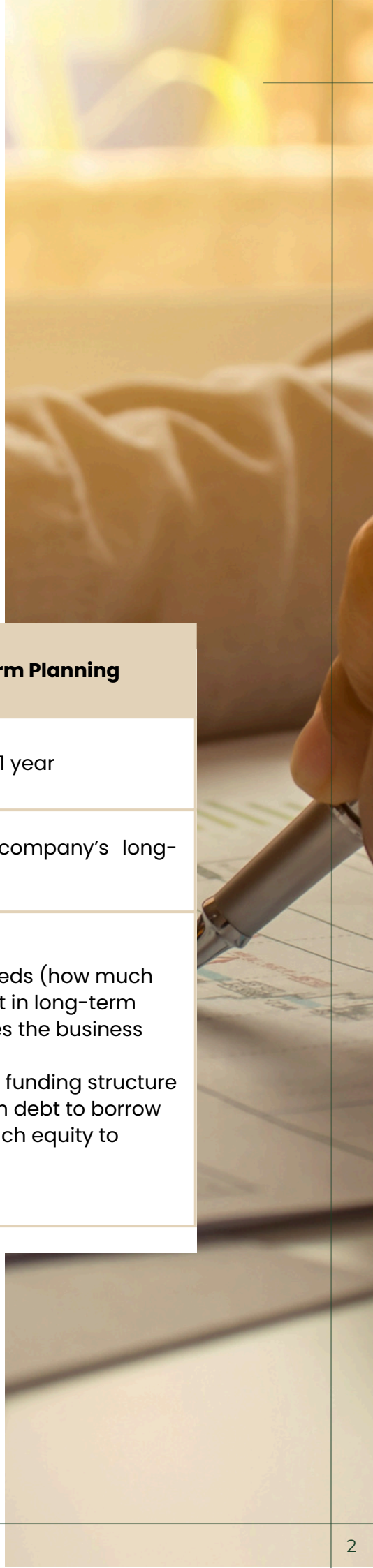
A financial plan serves as a **roadmap for your startup's financial success** - helping you assess operational profitability, determine investment needs, and identify potential problems early.

## Types of Financial Planning?

There are two main types of financial planning:

| | Short Term Planning | Long Term Planning |
|---|---|---|
| **Time Horizon** | 0-12 months | > 1 year |
| **Goal** | Make sure the company does not run out of cash | Support the company's long-term growth |
| **Focus Area** | • Sales<br>• Expenses<br>• Current assets (cash and other assets that can be converted into a cash within a year. E.g. inventories, receivables)<br>• Current liabilities (debts that need to be paid in within a year) | • Capital needs (how much investment in long-term assets does the business need?)<br>• Long-term funding structure (how much debt to borrow vs how much equity to raise?) |

**Short-term** and **Long-term planning are interconnected** as decisions in one affect the other.



# Sub components of financial plan

A business's finances are illustrated in 3 main financial statements:

1. **The Profit and Loss** (Income) Statement is a summary of your income, expenses, and profit over a certain period.

- The 3 main components of a Profit and Loss statement are Sales Income, Cost of Sales, and Operating Expenses.
- This statement helps determine the profitability of your operations.

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2. **The Balance Sheet** provides a picture of your startup's financial status at a particular moment.

- The 3 main components of a Balance Sheet are Assets, Liabilities, and Equity.
- This statement helps you analyze the financial health of your company (eg. do you have too much debt, do you have enough liquid assets).

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3. **The Cash Flow** Statement shows the movement of cash into and out of your startup over a certain period.

- The 3 main components of a cash flow statement are Cash flow from operations, Cash flow from investments, and Cash flow from financing.
- The main feature of this statement is that it considers cash transactions only. Sales made where customers have yet to pay or purchases made where the company has not paid yet are excluded from this statement.
- The Cash Flow Statement is critical, especially for startups and for short-term planning, because it helps you determine if you have enough cash to support your operations and plan for cash shortages.



# Why is Financial Planning Important?

A financial plan is critical for the success of your business as it can help you to:



1. Develop **realistic business strategies and goals** that are backed with the necessary financial resources.

2. Make sure your startup has **enough money to operate** smoothly and meet its financial commitments.

3. Make **informed decisions** about projects, investments, and operations.

4. Mitigate financial risks and uncertainties by having **contingency plans.**

5. **Gain investors' and partners' confidence** and increase your credibility.

# How to Implement Financial Planning?

We have broken down the financial planning process into 5 clear stages.

## 1 Define Your Strategic Goals

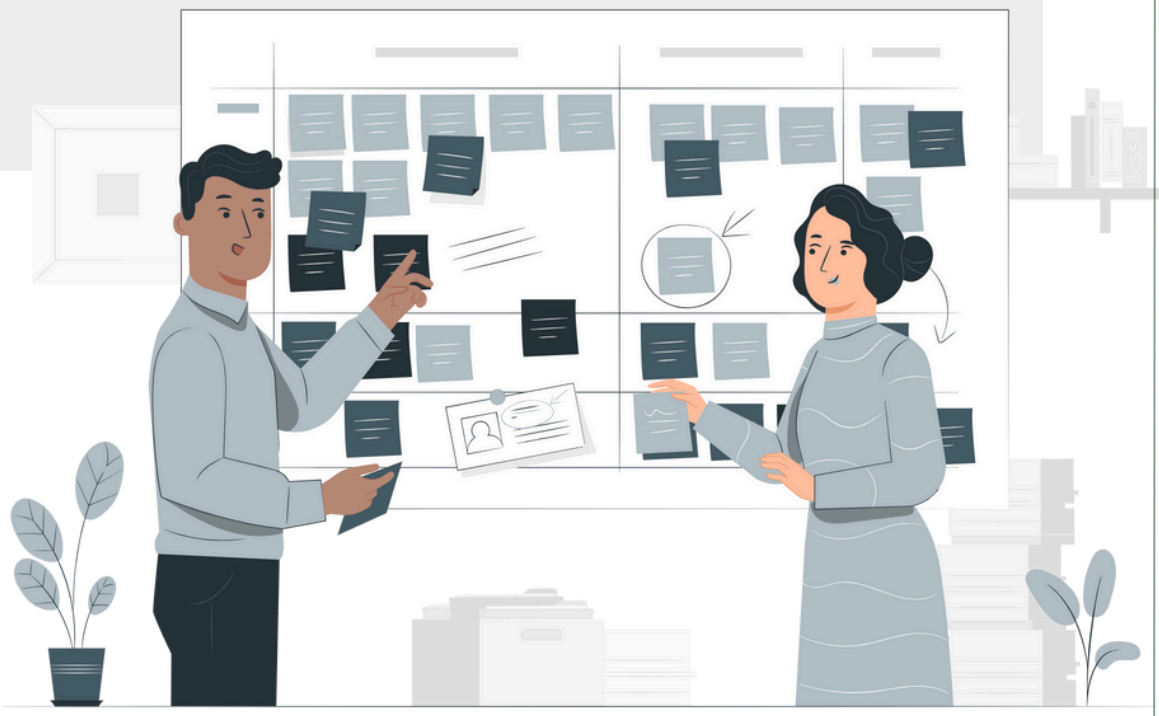
Be clear on what your business is trying to achieve.

***Practical Example***

*Imagine you want to start a café named "Urban House Café" to be one of the top cafes in the city. You determine that, to achieve this, you need to:*

1. *Open 10 locations strategically placed across the city to maximize your reach.*
2. *Generate monthly revenue of ETB 150,000 per location by attracting an average 50 number of customers per day with an average spending of ETB 100.*

*These goals serve as starting points for your financial plan. Your financial plan needs to work towards achieving these goals by ensuring you have all required resources in place.*



## 2 Forecast your financials

Make **an educated guess of how much your business will earn and spend.** The most important factor here is to **be as realistic as possible**. Develop best case scenario, base case scenario, and worst case scenario projections to be as prepared as possible for any eventuality.

Your financial forecast needs to include the below key numbers:

1. **Sales forecast:** an estimate of the sales revenue expected to be earned during the projection period.
2. **Expense forecast:** an estimate of the cost of running your business. There are 2 main types of costs you need to consider.
    - **Direct costs** are the costs you incur when you make and sell your products. These are the costs that fluctuate with your sales volume (they go up if you are selling more and go down if you are selling less).
    - **Operational/Indirect/Administrative costs** are the costs of running your operations. These are the costs that remain the same whether you sell more or less.
3. **Investment forecast:** an estimate of the funding required to set up, maintain, and/or grow your startup.
4. **Cash forecast:** an estimate of the company's cash inflows and outflows. The cash forecast helps you identify and plan for cash shortfalls.

**Financial forecasts are based on assumptions.** Eg. when you forecast that you will make ETB 10,000 next month in sales revenue, you are assuming that you will be able to find x number of customers to buy your product at x price and that you will be able to make and sell your product by x time, amongst other things. **Make a separate list of your assumptions to test their rationale and evaluate/revise them as necessary.**



**Practical Example**

Let's look at how you can forecast the sales, expenses and initial investment requirement for Urban House Café.

***Sales Forecast***

*Because Urban House Café is a brand new operation, you do not have any historical performance to base your sales forecast off. So how do you forecast sales for Urban House Café?*

*One way you can estimate sales could be by doing market research directly. In this case, let's imagine you decide to assess how similar cafes in the location you are targeting perform.*

*You go to one such café and sit there for an hour. In that hour, you count the number of customers that entered the café. You do this multiple times at different days and at different times of the day to collect as much data as possible.*

*Based on your assessment, you determine the average number of customers the café attracts per day. You then assess the average price of the items on the menu to determine the average daily revenue for the café.*

*You do this at 2-3 other similar cafes to have multiple data points. You then use these data points to estimate the sales for Urban House Café!*



***Direct Costs Forecast***

*For Urban House Café, direct costs could be the coffee beans for your coffees, the milk for your macchiatos, the flour for your cakes, and so on.*

*To forecast your direct costs, first determine the products you will sell in the café and make a list of all the inputs you need to make your products.*

*Based on your sales forecast, you know how much your café is projected to sell. And you know how much of each input you need to make one product. So you can use these figures to calculate the quantities you need for each input.*

*You then go talk to suppliers to determine the total cost of your inputs.*

***Operational Expenses Forecast***

*Determine everything you need to run your operations smoothly - for Urban House Café, these could be the rent for the café space, the salary for your employees, utilities (water, electricity, internet), and the taxes you have to pay amongst other things.*

*Estimate how much they will cost based on market price to project your total operational expenses.*



***Investment Forecast***

*There are several things you need to do before you can start Urban House Café. Some of which are listed below:*

- *You would need to secure the café space, which may require making deposit on a place*
- *You need to buy furniture and maybe hire interior designers to decorate your café*
- *You need to buy machineries and equipment to make your coffees and cakes*
- *You need to have an initial stock of supplies for your product*

*Make a comprehensive list of everything you need to set up operations (imagine the café up and running in your head. What is required to go from where you are now to that vision in your head?)*

*Determine the cost of all required items and you now have an estimate of your initial investment needs!*

** Please note that this example is provided to illustrate these concepts to you and give you ideas. In real life, the forecasting process is not going to be as simple as stated in this example - but we hope this gives you a starting point.**

## 3 Arrange Financing

Determine how you will meet your company's funding needs. There are several potential sources of external funding available including:

- Family/Friends
- Bank Loans
- Venture Capital
- Grants
- Awards/ Competitions
- Crowdfunding
- Incubator and Accelerators
- Microfinance/SACCOs

Do your research (search online, talk to people in your network, attend events organised for startups, expand your network by joining organisations for business/startups in your industry/location) to understand which of the potential funding sources is available to you. Determine the requirements to access available funding, the amount of funding available, and fit with your business needs to decide which one to pursue.



***Practical Example***

*For Urban House Café, you determine that you will need ETB 2Mn to set up operations.*

*You have ETB 200,000 of this amount saved with your local SACCO (Savings and Credit Cooperative Organisation) and they offer up to 3x your savings as a loan. You can thus cover ETB 600,000 of your initial capital from this.*

*You talk to your friends and family, and find some people willing to lend you another ETB 300,000 of the required amount to be paid back in a year.*

*You are still short ETB 1,100,000.*

*You go to your local bank to apply for a loan, but they require collateral to lend you the money, which you do not have.*

*You need to look for other sources of funding.*

*You sit down and think about what makes you unique as a café that could potentially allow you to access startup funding (venture capital, angel investment, grants, awards, and so on).*

*You know you want your café to have a social impact. You have been tossing an idea of a TOMs Shoes (the company that donates 1 shoe for each shoe sold) like model in your head - for every meal you sell, you want to donate one healthy snack.*

*You develop an investment proposal for Urban House Café which highlights its unique selling points, social impact, and financial viability.*

*You believe this could potentially get you access to grant funding to cover the remaining funding needs and you start reaching out to funders to find out more about available funding plus funding requirements.*



*** Please note that this example is provided to illustrate these concepts to you and give you ideas. In real life, the fundraising process is a long and hard process - and not as simple as stated here.***

## 4 Plan for Contingencies

Be prepared for things to not go according to plan

- List all the assumptions you made in your financial forecast (Look at each number and determine what has to happen for that number to be realistic).
- Consider what could happen to make your assumptions wrong and determine the financial implication of each wrong assumption.
- Make a plan for how you will mitigate against the risk or what you will do to address the issue if your assumptions are proven wrong.

***Practical Example***

*You had made a number of assumptions when you prepared the Urban House Café financial plan. From your list of assumptions, you determine that the most uncertain ones are your assumed starting date, your assumed customer adoption rate, and your assumed input prices.*

*For your starting date, you had assumed that you will be able to raise the required funds, secure a space, purchase the required equipment, hire people, and start operations in 6 months time.*

*Looking at your financial projections, if this assumption is proven to be wrong, each month of delay in setting up operations could cost you additional ETB 200,000.*

*To give yourself a buffer zone to mitigate the risk of time delay, you decide to delay some financial commitments (e.g. to hire people only after everything is set up) and to fast track some processes that could potentially be causes of delay (e.g. to procure machineries and furniture immediately).*

*** Please note that this example is provided to illustrate these concepts to you and give you ideas. In real life, planning for contingencies may not be as simple as stated in this example - but we hope this gives you a starting point.***



## 5 Monitor Performance

Regularly review your actual performance and compare against your plan to make adjustments as needed.

***Practical Example***

*For Urban House Cafe, you define the key performance indicators you want to track: sale revenue, number of customers per day, average spending per customer, the direct costs per item, and the monthly operational costs.*
*You design a simple excel model to track these numbers and you assign your accountant to make you regular reports on these figures using the model.*

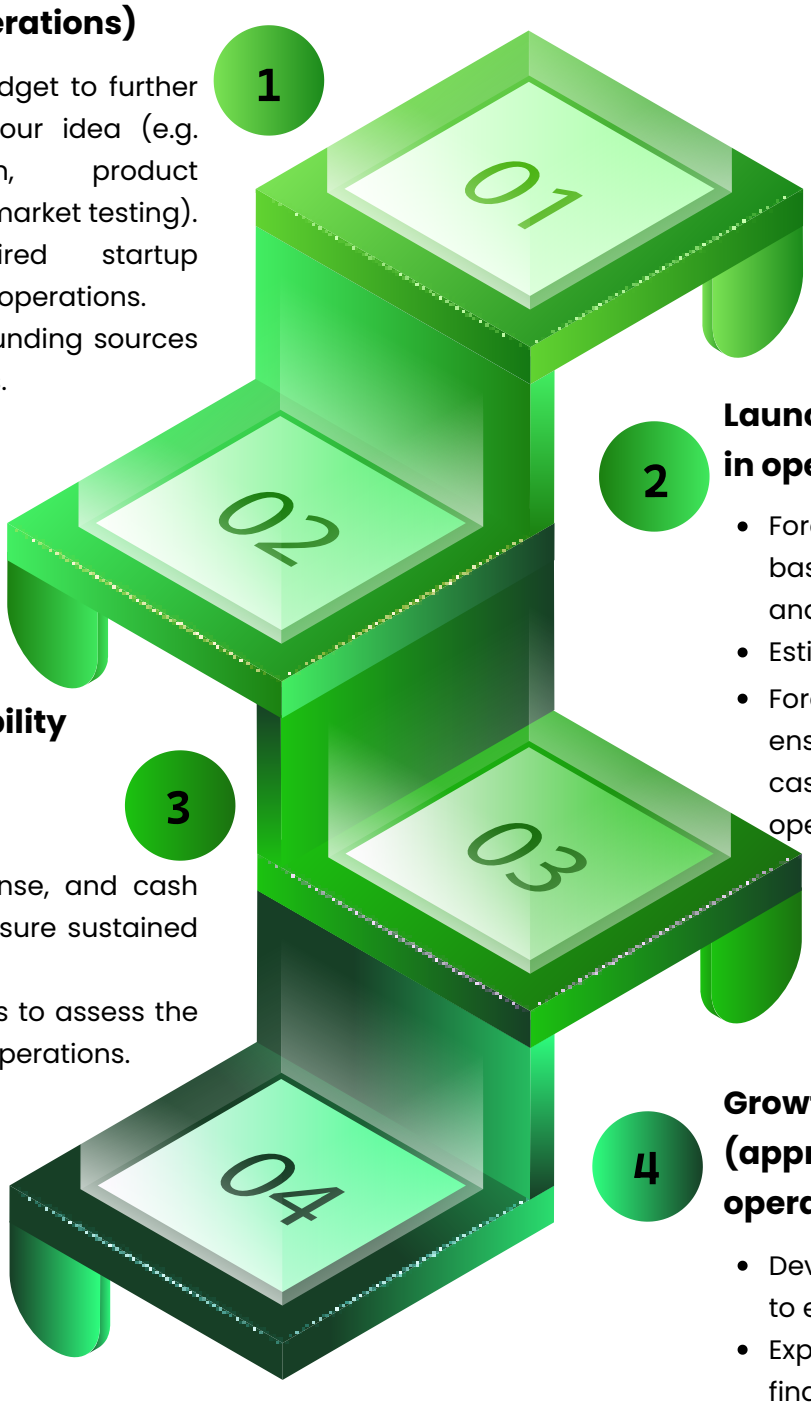


# What does financial plan look like at different stages of a startup

While the components of a financial plan are fairly standard, your areas of focus would differ based on what stage your company is in.
Below we look at 4 stages of startup and the focus for each stage.

### Idea Stage (pre-operations)

- Developing initial budget to further develop and test your idea (e.g. market research, product development, initial market testing).
- Determining required startup investment to set up operations.
- Exploring available funding sources for initial investments.




### Launch (approx 0-1 years in operations)

- Forecasting sales revenue based on market research and initial market testing
- Estimating operating budget.
- Forecasting cash flows to ensure you will have enough cash liquidity to fund operations.

### Proof of business viability (approx 1 - 3 years in operations)

- Detailed sales, expense, and cash flow projection to ensure sustained operations.
- Performance analysis to assess the financial viability of operations.

### Growth and scale (approx 3+ years in operations)

- Developing detailed budget to expand operations.
- Exploring funding sources to finance expansion.
- Detailed cash flow forecasting to ensure company has enough funds to fund operations and expansion.

# Authors

This document is prepared in a partnership between ACE Investment and Impact Advisors and Cofounder.

**ACE Investment and Impact Advisors** is a management consultancy and advisory firm that is dedicated to promoting innovation for better development outcomes and social change. To this end, ACE identifies, partners with, and supports startups to grow through a holistic approach of strategy, analysis, infrastructure, and finance provision.

**Cofounder** is an organization with the mission to demystify the startup landscape by offering a practical and accessible solution that simplifies and streamlines startup management. To this end, Cofounder develops and offers tools that assists startups in a range of business management areas, spanning from strategy development to financial management and operational oversight.

For additional information and support, you can reach us at the below contact addresses:


**ACE Investment and Impact Advisors**
Website: www.aceadvisors.org
Email: contact@aceadvisors.org
Phone: +251-962-001-111

**Cofounder**
Website: cofounderpartners.com
Email: admin@cofounderpartners.com
Phone: +251-944-143-040


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