Part 10: How to write an Information Memorandum or Business Plan to Raise Capital – 'Financial Information'

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This is a continuing series of articles on how to write a Business Plan or Information Memorandum to raise capital, Part 10 discusses the business plan content specifically 'Financial Information'.

Financial Information

This section is important as it represents the 'gelling together' of the business plan in the form of financial projections. It should include:-

1. Details of any previous financial record explaining briefly, historic trends and hiccups if any. If available, the past *5* years' results should be summarized and the audited accounts together with latest management figures included in the appendices.

2. A summary of projected results for the next 3 to *5* years concentrating on the principal features of the projections, trends, rising and falling margins, fluctuations, commitment to R&D, major capital expenditure and key assumptions. Detailed projections together with the assumptions on which they are based should be provided in the appendices and should include:-

   (a) Profit and loss accounts by month for at least 12 months, preferably 3 years, annually thereafter. The breakeven point should be clearly identified.

   (b) Cash flow projections, monthly and yearly as above

   (c) Balance sheets, monthly and yearly as above

3. A commentary on the forecasts considering the overall shape of the company as projected rather than a detailed review of specific points.

4. The nature of existing or planned financial reporting and control systems.

5. Sensitivity analysis covering key risk areas and a summary of the effects of such on the projections, in particular their impact on the funding requirement.

Investors routinely expect business plans to project sales, profits and other financial information for 3 to *5* years into the future. These projections are basic to the evaluation of the investment opportunity and to a large extent will determine how much of the company's equity, investors will expect in return for their investment.

Projections must represent the entrepreneur's best estimate of future operations and should be supported by the strategies described in the previous sections of the business plan. They should also provide the operating plan for the financial management of the venture.

When compiling projections, always work from top downwards, ie. start with the sales projections determined by the market and market strategy sections. It is a common mistake to project from the manufacturing cost level on the assumption that everything that can be made will be sold by the sales team. Additional salesmen do not necessarily equal greater sales!

Although profit and loss statements are important from the point of view of probable returns (again, the need for realism is stressed: forecasts which are too optimistic or too pessimistic have little value as aids to decision making and policy formulation), the cash flow forecast can be more critical as it details the amount and timing of expected cash inflows and outflows. Generally the level of profits, particularly during the early years of a venture, will be insufficient to meet the working capital needs and, as inflows do not match outflows on a short term basis, this forecast allows management to identify and plan cash needs. It also helps the investor ascertain the finance required.

Balance sheet information details the assets required to support projected levels of operation and shows how these assets are to be financed (liabilities). These are important tools for both investors and banks who will analyze balance sheet ratios to determine whether they are within acceptable limits to justify investment. The opening balance sheet will form the base for the financial projections. It is important to state when it was compiled and from what source (year end audited position, monthly management figures or blank piece of paper).

Once the company's projections have been prepared it is necessary to draw upon section 9 of the business plan to highlight any major risks that could prevent the achievement of the forecasts and the sensitivity of the figures to these risks. Although a venture capitalist will form his own view about risk factors he will take note of the company's own view about risk factors and he will take note of the company's own assessment. Using the original projections as the 'base' both positive and negative sensitivities should be considered such that a best, worst and median set of projections results. As a result, the total finance required, plus contingency to take account of principal risk areas, will be determined.

The ability to meet income and cash flow projections will depend upon the company's ability to monitor and control costs. Investors will want to know what accounting and cost control systems are or will be employed by the business and hence brief details should be given.

The content of Business Plans will be further covered in subsequent articles by Len McDowall.

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About Len McDowall - Managing Director, Integral Capital Group Pty Ltd

Len McDowall was previously inaugural Chairman and Managing Partner of Bird Cameron Chartered Accountants (now known as RMS Bird Cameron), which employed 1000 people in 50 offices in Australia and Hong Kong. Len, who established Bird Cameron's mergers and acquisitions division, has extensive experience in all facets of financial management with a particular emphasis on structuring and negotiating joint ventures and capital raisings. Following his retirement from the accounting profession Len and his partners established the Integral Capital Group in 1990 which specialises in mergers and acquisitions, public floatation's and capital raisings.