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Special Issue

AgEnt Agri-Business Management/Marketing Workshop: Key Agri-Business Management Components

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AgEnt

HELPING SRI LANKA TO GROW !

AgEnt is a dynamic USAID funded private sector agro-enterprise development initiative successfully assisting companies and entrepreneurs with viable business/marketing plans to expand existing operations or start-up new ventures targeted at both domestic and export markets.

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AGRIBUSINESS MANAGEMENT/MARKETING WORKSHOP

I. INTRODUCTION

The marketing of Agricultural products and management of agribusinesses require considerable skills. As more sellers of agricultural products enter the market, competition becomes more intense. A good job of marketing and managing the business is required in order for the business to survive.

The customer ultimately determines how much will be purchased at various prices. Customers' willingness to buy and the quantities offered for sale determine prices. For most agricultural products many buyers, sellers, processors, and wholesalers are located between farmers and consumers.

Consumers worldwide and the total quantities offered for sale worldwide influence prices at various levels in the market at all locations. An agribusiness, considering entering the market or changing what it has traditionally done, should carefully make advanced studies of the likely effect upon the business if the proposed plans are carried out.

This workshop sponsored by USAID through AgEnt is for the purpose of making clients aware of some of the more important agribusiness marketing and management topics leading to the success of their business. In the time allocated to such an important subject, we shall only be able to cover general conditions which apply to many products. The level of skills and experiences of those participating in the workshop is highly variable as well as the agricultural products they represent.

Good sound marketing and management principles will be the subject of the workshop. For some of those in attendance perhaps a higher level of instruction could have been used. We selected a level of delivery which best matches the skills and experiences for most of you. You are receiving copies of the materials to be studied in more details later.

Perhaps the most important thing we can do for you is to make you aware that AgEnt has specialists available to work with you on your agribusiness problems from production to marketing.

Considerable planning went into the development of the materials for this workshop. AgEnt started by advertising among many universities in the U.S. to locate instructors with agribusiness experience to conduct it. AgEnt has had underway a survey of agribusiness managers to discover what these managers think is needed in management training. A sampling of the business profile of AgEnt clients has been used as well as AgEnt staff advice to develop the workshop. Perhaps even more important, a large number of Sri Lanka agribusiness leaders holding a wide variety of positions were individually consulted for their advice with regard to subject matter and level.

Prefaced by these remarks, we shall proceed to a broad overview of the agribusiness food system and stress the need for an economic feasibility analysis any time you consider making changes in your business.

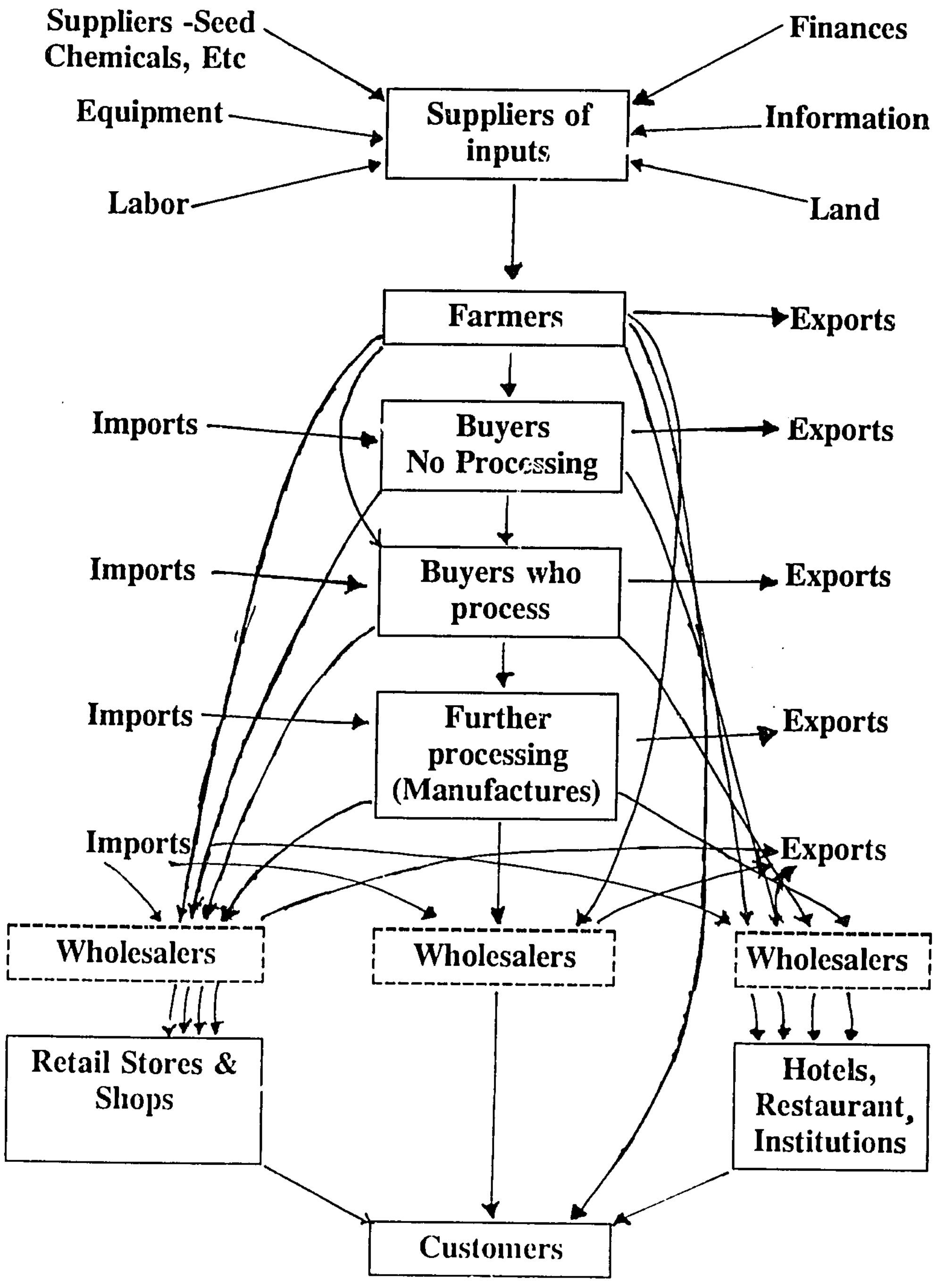
A. OVERVIEW OF THE FOOD SYSTEM

When a farmer sells directly to a customer, that part of the system seems simple enough. On the other extreme, I can assure you that the diagram which follows does not show all the steps in the marketing for some products. Hopefully, you will appreciate that what you can sell and the price you receive relate to the stages shown in the diagram.

FACILITATING ACTIVITIES - RELATED TO THE FOOD MARKETING SYSTEM

1. FINANCING
2. GRADES AND STANDARDS
   a. Need acceptable grading
   b. Need enforcement of weights and measures.

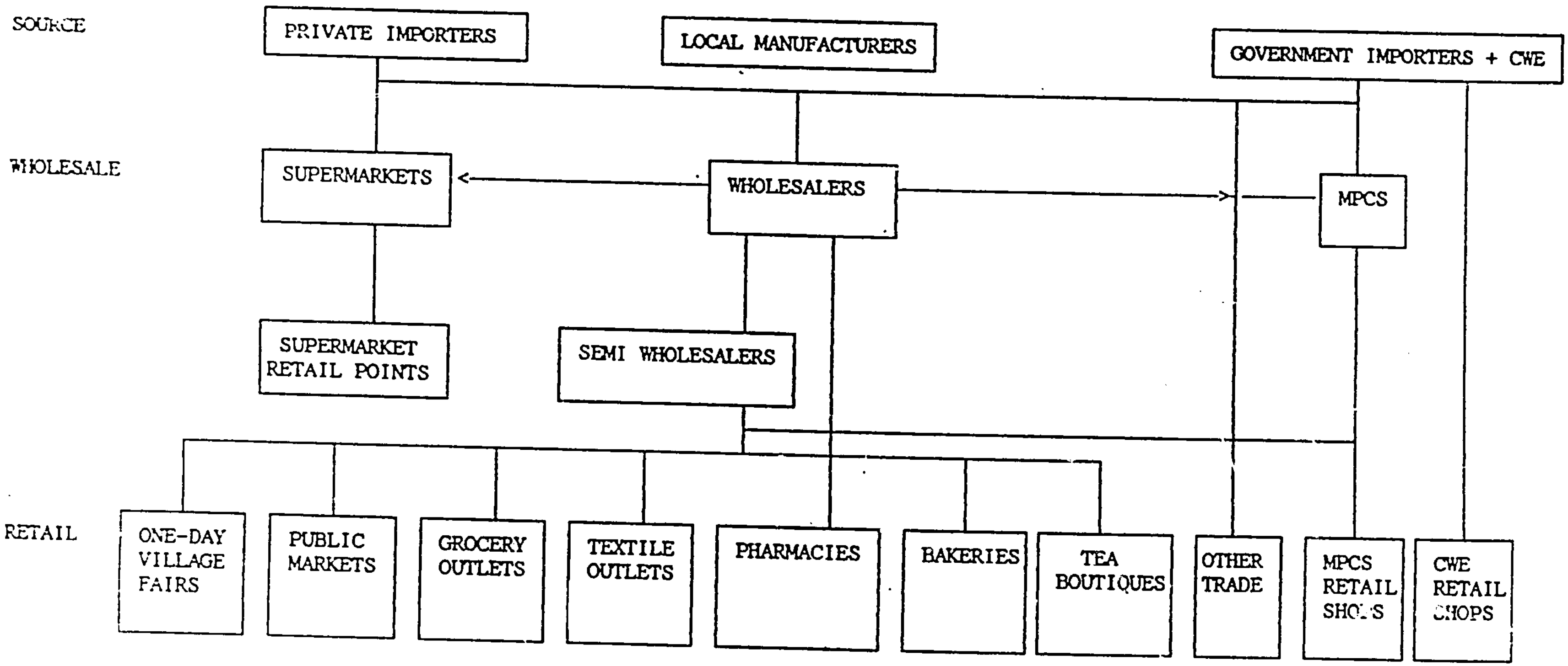
AGRI-BUSINESS FOOD MARKETING SYSTEM



Each level or stage in the channel represents a market. Movement through the system requires transportation and storage.

SRI LANKA

TRADE AND DISTRIBUTION STRUCTURE



3. INFORMATION

a. Technical Assistance

b. Production - Domestic and World

1) Hectares planted and harvested

2) Yield

3) Production

c. Market - Domestic and World.

1) Prices

2) Volume Sold

3) Inventories

B. ECONOMIC FEASIBILITY ANALYSIS

1. COMPONENTS

a. Market Potential

1) Total domestic and/or International

2) Firm's Potential share

3) Competition

b. Raw Material Supply

1) Quantity

2) Quality and uniformity

3) Dependability

4) At a price which allow for a profit

c. Financial Evaluation of proposed business

1) Potential return on Investment

2) Risk

2. HOW UNIT COSTS VARY WITH SIZE AND CAPACITY

a. Cost Variation Dependent upon size

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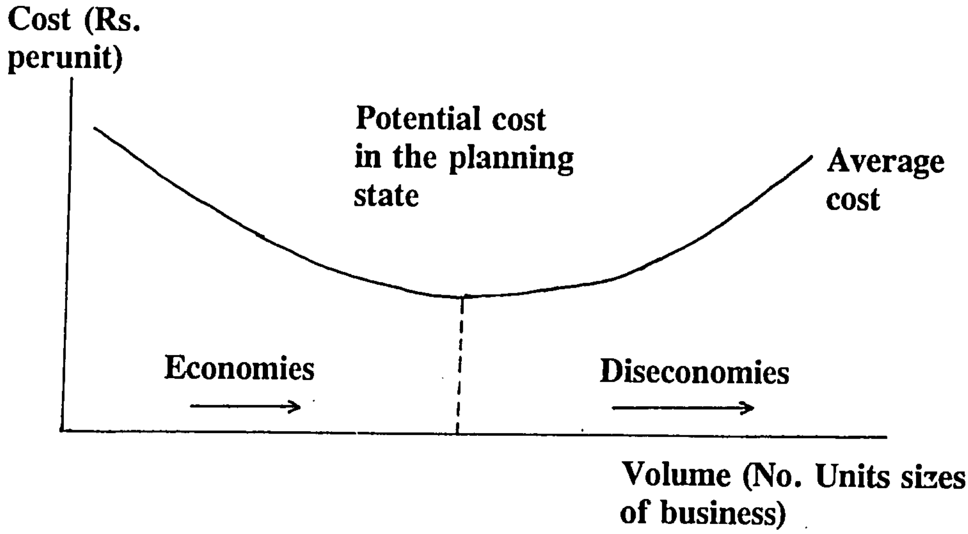
1 Included in your materials is a copy of Richards W. Schermerhorn, 1978. Economic feasibility analysis - what is it and how should it be done. cooperative extension service, University of Hawaii, miscellaneous publication 153.

2. HOW UNIT COSTS VARY WITH SIZE AND CAPACITY

a. COST VARIATION DEPENDENT UPON SIZE



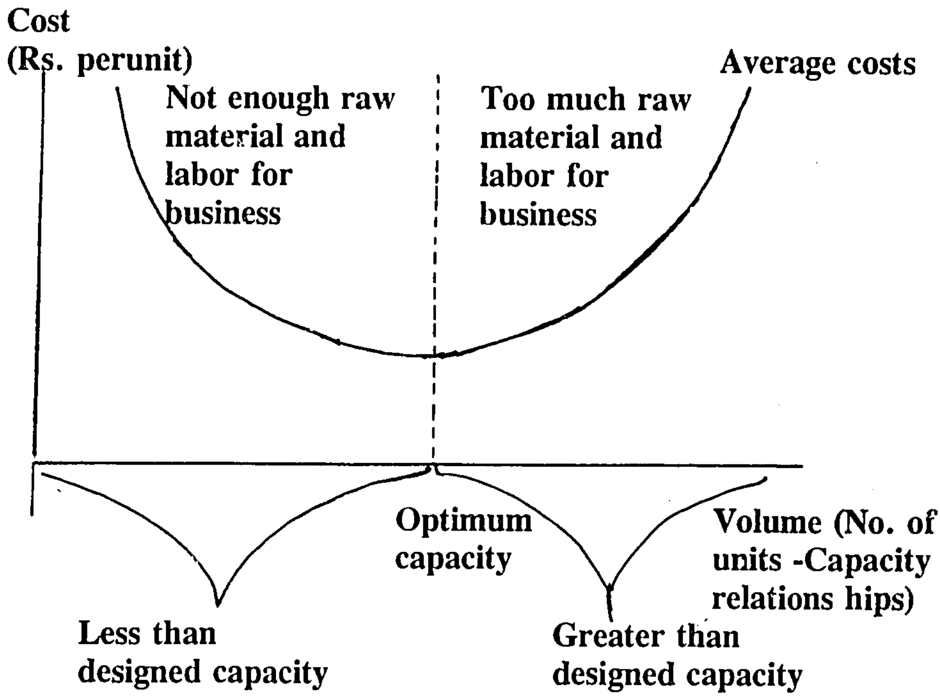
CAUSES OF ECONOMIES

1. Specialization
2. Large equipment more efficient
3. Better quality and utilization of management

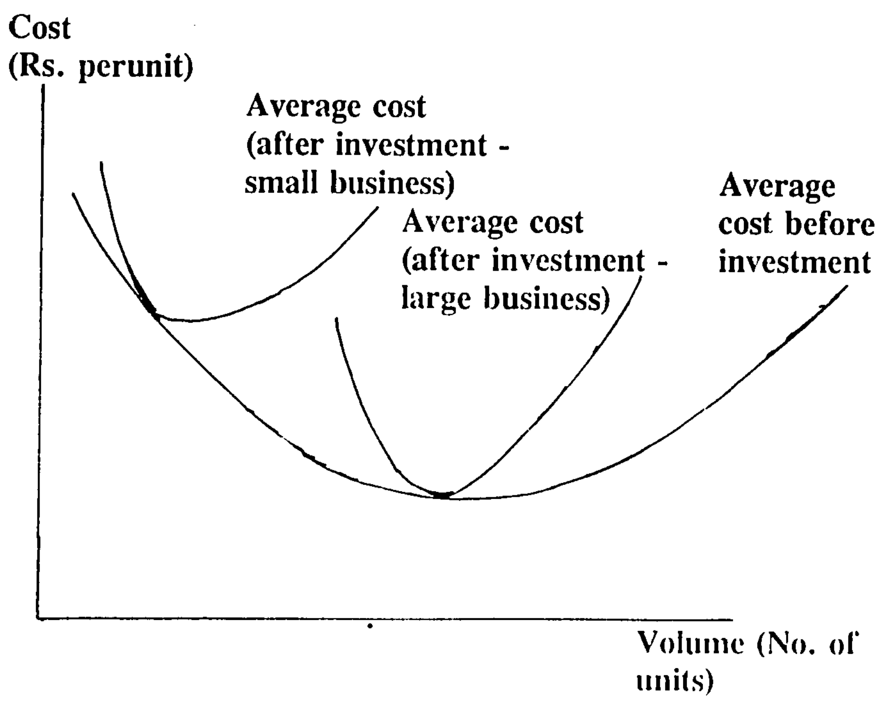
CAUSES OF DISECONOMIES

1. Lack of coordination
2. Assembly of raw material costs
3. Distribution cost of finish products

b. COST VARIATION DUE TO UTILIZATION RELATIVE TO CAPACITY COST OF PRODUCTION AFTER MAKE INVESTMENT IN A PARTICULAR BUSINESS



c. Cost Variation due to size and capacity Utilization



3. COMPETITION

Competition for the market may take many forms. However it is important to be efficient with regard to costs. How does the size of your business compare with that of competitors ? Who has the size advantage ?

NOTE : If technology differs costs as illustrated above not be directly comparable.

Are you operating your business near it's designed capacity ? Do you need to make adjustments in the business in order to make it more efficient with regard to cost per unit ?

There are many features of competition. A new agribusiness should carefully study its competition. In addition to potential cost advantage, competitors may have more experience, be well financed, have diversified activity to help cover risk, etc.

Domestically, competition can cause problems by not knowing their costs and price the product too cheaply. Sometimes a new business will begin not realizing there is not enough market for another business.

ECONOMIC FEASIBILITY ANALYSIS
What Is It and How Should It Be Done

Richard W. Schermerhorn
Visiting Specialist in Agricultural Economics
Cooperative Extension Service
University of Hawaii

February 1978

Cooperative Extension Service
University of Hawaii
Miscellaneous Publication 153

ECONOMIC FEASIBILITY ANALYSIS
WHAT IS IT AND HOW SHOULD IT BE DONE

R.W. Schermerhorn

Introduction

Hawaiian agriculture is rapidly changing as a result of many factors, among which are: (1) better agricultural land is being absorbed by the demands of a soaring population and urbanization which is restricting agricultural expansion; (2) in remaining production areas inadequate water supply limits agricultural development; (3) increasing production costs caused by high costs of labor and transportation of farm input items and equipment from the mainland; (4) a transition from the traditional agricultural giants (sugar and pineapple) to a diversified agriculture which necessitates identification of commodities that show potential for growth both in terms of production feasibility and potential markets; (5) a changing market structure faced by agricultural producers, i.e., large scale buyers that demand that products be readily available, in adequate supply of high uniform quality, and offered at competitive prices; (6) increased energy costs resulting in high transportation costs of products to mainland markets; and (7) increasing competition from mainland products which can be produced at a lower cost and shipped to Hawaii and sold for less than locally produced commodities.

Although the above list is not exhaustive, it points out the multi-faceted changes affecting Hawaiian agriculture. To cope with these changes, agriculture in Hawaii must constantly search for alternative types of agricultural enterprises and/or alternative methods of producing and marketing locally produced commodities. Further, and most important, before any new enterprise or method of producing and marketing a product is initiated, it should be determined that it is economically sound; i.e., will it be profitable? A feasibility study is designed to determine whether or not a specific proposal is economically sound. This publication reviews the types of situations requiring feasibility analysis and then discusses what is involved in conducting a feasibility analysis study. It is hoped that this publication will serve as a guide to conducting adequate and meaningful feasibility studies.

Types of Situations Requiring Feasibility Analysis

The following is a partial listing of various types of situations that should require a feasibility analysis before making a final decision:

1. When the firm is considering any type of combination or alliance of firms to improve the operating position and further the common interest of these firms. This situation includes mergers, acquisitions, consolidation and/or federation. In most cases, the need for this type of reorganization stems from either a decline in volume handled by the agribusiness firms, a change in the market structure which requires larger volumes to supply buyers, and/or the need to assure a supply of inputs or a market for the production of

the firm. Further, duplicated efforts can often be eliminated and thereby reduce costs if two or more firms are consolidated.

2. When a firm is considering expansion of present facilities. Many times this desire may stem from expanded demands for goods or services or from an attempt to gain economies of size in the production process.
3. When a firm is considering building new facilities. This becomes important when facilities become obsolete, which many have over the past few years, and are now finding it difficult to compete.
4. When a firm is considering relocation or a new location. This may be a result of changing conditions within a specific area, such as a change in wage rates or public opinion regarding pollution control, or it may be a result of a decline or increase in production of the raw product in the area due to competitive advantages relative to another area.
5. When a firm is considering adoption of new technology. This situation is continually arising as technology is rapidly changing in many of our agri-business industries. In fact, new technology is being forced on many firms due to changing sanitation requirements and/or changing pollution standards.
6. When a firm is considering adding a new service or product line. Many of our cooperatives have added services and products over the years simply because their members expressed a need. Many of these products or services have been added without the benefit of a feasibility analysis to determine if the addition would be profitable. As a consequence, many have been unprofitable.

7. When the firm is considering geographical expansion of its market area. Many agri-business firms have expanded their market area in an attempt to gain a larger share of the market and in turn achieve a greater ability to negotiate price with buyers and/or sellers.
8. When the firm is considering diversification of its operations. Many of our agri-business firms have diversified in an attempt to eliminate reliance on one product group, to reduce overhead costs, and to more fully utilize existing facilities or distribution channels.
9. When a group is considering entering a new venture, such as the formation of a cooperative to purchase farm inputs or to collectively market the products of the farmer members.
10. When a farmer or group of farmers is considering entering the production and/or marketing of a new commodity.

In short, it is necessary to conduct a feasibility analysis anytime a firm considers any change in its present operating situation. Why? Because the ultimate purpose of conducting a feasibility analysis is to avoid the costs associated with making a wrong decision.

It can readily be seen from the above listing that the term feasibility is extremely broad and covers a multitude of varying situations that may develop in individual agribusiness firms. As a consequence, the content of and the methodology followed in conducting any given feasibility study could and does vary considerably.[1/] For this reason, the following sections

1/ A listing of selected feasibility studies conducted by the Department of Agricultural and Resource Economics, University of Hawaii, is included as Appendix B. This list will illustrate the types of feasibility studies that are conducted.

will discuss the content of a complete feasibility study; i.e., what is involved in conducting a feasibility analysis of a completely new enterprise proposal. This will allow comments related to analyzing partial projects, such as an agribusiness firm building a new facility to complement its on-going business or adding a new service to better serve its clientele.

For the convenience of the user of this publication, Appendix A summarizes the elements of a complete feasibility analysis in outline form. It is felt that this outline form may be more convenient to follow as a guide to conducting a feasibility study.

Conducting a Complete Feasibility Analysis

A complete feasibility study can be divided into two major phases. An analysis of directly influencing factors, and an analysis of environmental conditions.

Analysis of Directly Influencing Factors

This phase of a complete feasibility study is designed to provide the basic information required for determining whether or not the proposed enterprise can economically survive. It is the phase that provides the basic information required for loan applications and determines whether or not the enterprise can make profits and be able to pay the interest and principle associated with the loan. In short, this phase of a feasibility study is designed to answer three questions: (1) What factors must be considered to tell us whether or not we should go into the business (raw product, markets, etc.)? (2) How much will it cost us to enter the business and what facilities will we need? and (3) How much profit can we make?

The analysis of directly influencing factors phase of a feasibility study can be divided into three parts: (1) market determination, (2) raw product supply, and (3) the production process.

Market Determination. In most feasibility studies, determination of the market for a product or service is the most difficult part of the analysis to conduct. This, however, generally is not true for cooperatives considering adding a new service or product for their membership--the membership can be surveyed to determine the existing market. But whenever the firm is considering marketing a product for its membership or clients, the market analysis becomes much more difficult.

The market analysis, however difficult to conduct, must be done. The availability of a market is critical to the success of any agribusiness venture. If a market does not exist for a product, there is no economic rationale for entering the production of the product; and, as a consequence, the feasibility analysis can be terminated.

To adequately analyze the market potential for our product, we need to determine current and potential consumption of the product or service, types of markets we will use, types of distribution systems we will use, how we are going to enter the market, types of buyers we will attempt to sell, the types of selling arrangements we will use, and the prices we will charge for our product. The following breaks down each of these factors and discusses what should be analyzed to answer these questions.

1. Consumption. We need to determine current consumption of our product or service, the trends in this consumption, the current consumption and trends in consumption of competing products or service; in what form, qualities, volumes, etc. is our product

or service consumed; who is currently providing for consumption demands; how will competitors react if we enter the market; at what capacity are current competitors operating; and can we compete with them?

2. Markets. If a cooperative is supplying a product or service to its members, this will be its market. However, if a firm is considering marketing its members' product or a product it is purchasing for resale, then we need to know what kind of markets exist; where are these markets, domestic or international; and what will it cost to serve these markets?

3. Distribution system. Next we need to know what type of distribution system will best fit our needs. We need to determine whether we will have our own sales force or use brokers and the cost involved; whether we will market under our own brand versus a buyer's brand; will we transport the product to the market, and if so what method will we use; should we buy or lease equipment, and what will be the cost?

4. Market entry. We next need to determine how our product will be introduced in the market--through lower prices, advertising and promotion, or some other method; how long will it take to build up the market to desired sales volume; and what will be the costs involved?

5. Buyers. Who will be our buyers is the next question. What types of buyers--chain stores, wholesalers or institutions in the case of consumer products; what quantities will they require; what product specifications will the buyers require; how reliable are

buyers; have they indicated interest in our product; and what kind of commitment will they make to buy our product?

6. Selling arrangement. What kind of selling arrangements will we encounter needs to be answered next. What kind of pricing arrangements will we make; what kind of delivery schedules will be required; what kind of payment schedules will we encounter; what kind of services will we have to provide with our product, and what will be the costs involved; will we have sales offices and, if so, where should they be; how many salesmen should we have; what type of compensation plans should we have for salesmen; and what will all this cost?

7. Prices. Critical to our entire analysis is the question, what price can we expect to charge for our product or service? This question can be partially answered by analysis of past prices and price trends and, based upon this analysis, project future expected prices in light of expected future consumption demands as affected by expected future economic conditions. This, of course, is a relatively difficult task, especially if we attempt to predict prices very far into the future. We should obviously take into consideration in our predictions the expectations of buyers and other suppliers of our product.

Raw Product Supply. This part of the analysis concentrates upon determining the economic availability of the raw product inputs for the proposed enterprise--fat cattle for a meat packing plant; feeder cattle and feed grain for a feedlot; vegetables for a packing shed or a processing plant; macadamia nuts for a shelling and roasting plant; broilers for a poultry processing plant; grain for a feed mill, etc.

There are usually four basic factors that need to be analyzed when determining raw product supply:

1. The minimum economic size of the controlling facility. Determination of the minimum economic size of the facility will in turn set the amount of raw product required to reach this scale of operation. We might, for example, determine that the minimum size meat packing plant, considering today's level of technology, would be 20 head per hour; or 500 birds per hour in a broiler processing plant; or 20,000 pounds of raw fruit per day in a passion fruit processing plant.

   The minimum economic size of facility can be determined by actual cost analysis of existing plants or synthesizing model facilities from specifications from equipment companies.

2. Plant requirements. Following the determination of the minimum size economic facility, we will know how much raw product will be required. For example, we would need to procure for the above mentioned facilities: 41,600 head of cattle annually for the packing plant operating 8 hours per day, 5 days per week, 52 weeks per year; or, 1 million broilers annually for the processing plant operating on the same schedule as the meat packing plant; or, the production from about 400 acres of passion fruit for the processing plant if it operates 100 days per year.

3. Availability of requirements. Now that we know the amount of raw product required, we must determine whether or not this quantity is available of adequate quality and at a price we can afford to pay. Further, there has usually evolved for any given agribusiness a

maximum distance from the facility within which the firm must draw its raw product. In many cases, this distance is determined by the effect on quality of time between harvest and processing. In other cases, economics of transportation define the area within which the facility draws its raw product--for example, it is common practice for most broiler processing firms to draw broilers and deliver feed within a 25-mile or less radius of the facility.

With these factors or limitations in mind, we can proceed with the determination of the availability of the raw product. Usually this involves a survey of the defined production area (the drawing area for the plant). The survey would most likely be an analysis of statistical production data for the area to determine if there is enough production of raw material to allow economic operation of the facility. The survey may also include a personal survey of the growers in the area to determine future production plans and future price expectations. Further, in the case where the present volume of production is not adequate for facility needs, a survey should be made of potential producers to determine their willingness to enter production of the raw product.

4. Assured supply of requirements. It is not enough to know that there is currently adequate production in the area for plant needs. What we must know is whether we can be assured that we can secure what we need. In other words, is the source of raw material dependable? What arrangements can be made for procurement? Would growers sign long-term contracts to assure adequate source of supply? -- And this applies to cooperatives as well as non-cooperatives.

It is also important to determine what is the current market use of the raw product--then, what degree of market entry appears possible; i.e., can we compete for this use.

To summarize the supply determination phase of a feasibility study, we need to know how much raw material we will need in order to operate our facility at an economic size, and then we need to know, is this raw product available economically and is this source of supply dependable.

Production Process. This phase of a feasibility study analyzes the production process of the proposed facility. It analyzes the specific facility needs, capital requirements, financing requirements and the potential costs and returns from the operation of the facilities.

1. Facility determination. In the discussion of the supply determination, the necessity of first determining the minimum size of the controlling facility was discussed. In most of the agri-business undertakings today, there are multi-facilities involved and one is the limiting facility to the rest. For example, the processing plant in an integrated broiler operation is usually the limiting facility and all other facilities (hatchery, grow-out, feed mill, etc.) must be geared to the processing plant. This phase of the analysis is involved with determining the specific facility needs for the entire operation. In this stage, special analysis must be made of current stages of technology which the enterprise can adopt, and must adopt, in order to compete within the competitive environment it must operate.

2. Investment capital needs. Once specific facility needs have been determined, we are in the position to determine what these facilities

will cost; i.e., how much will be our initial investment needs. This part of the study is relatively easy to prepare once it is decided exactly what types of facilities we want. Our costs then, are estimates from the equipment companies, construction companies, utility companies, etc.

3. Labor needs. Following facility needs determination, we can estimate our labor needs. We will know it takes so many persons to operate a feed mill, processing plant, or whatever. We can then compare our needs to the available labor force in the area. It should be emphasized at this point that a given percent unemployed in an area is not an indication as to the available labor force nor their willingness to work at a particular type of work.

   The other part of the labor needs question involves the availability of management and technically trained persons. This, obviously, is an extremely important factor which generally will dictate the success or failure of the undertaking.

4. Cost of operation. This phase of the study analyzes the information thus far determined by applying appropriate wage rates, management costs, raw material input costs, various operational costs such as utility rate structures, and fixed costs of repairs and maintenance, depreciation, interest, taxes, and insurance. This process should involve the development of cost budgets for the various phases of the operation. The result will provide a per unit cost of operation.

5. Profitability. With costs of operation determined, profitability of the operation can be projected following estimation of expected prices. (Price projections was discussed in an earlier section

of this publication.) A projected income statement must be prepared to determine the profitability of the operation. Also, preparation of a "break-even chart" is recommended which will show at what level of production, given our costs and returns information, we will be able to break-even (cover all costs of operation). Further, one can use various projected price levels in the chart to determine break-even points at various levels. Many times the importance of a break-even chart is in knowing the minimum level of production that must be marketed to achieve the break-even point. If, for example, we can contract this amount of production, we can at least break even on the operation.

6. Working capital needs. Completion of the projected income statement has been the end of the feasibility study for many agri-business firms. However, the most important item has yet to be included in the study--the cash flow summary. Provision for adequate working capital is perhaps the critical item for the successful operation of a business. It is necessary to prepare a cash flow summary to determine what the cash needs will be for the firm and the sources of cash available to meet these needs.

To be more specific, we need to know how much capital will be needed for day-to-day operation of the facilities (wages, inventories, utilities, raw product, etc.) and when this capital will be required. Further, we need to know where this capital is going to come from; i.e., receipts, borrowings, membership equity, etc. The cash flow is also required to help determine size of loans, length of loans, probable pay-back periods, and amount of interest and principle that can be periodically paid back. In short, it is an absolute necessity to include a cash flow summary in the feasibility study. Too many agribusiness firms find themselves in extremely poor operating condition because they didn't adequately provide for working capital.

To summarize the production process stage of a feasibility study, we need to know: what facilities we need; how much they will cost; what our operational items such as labor, utilities, and raw product will cost; how much profit will we make; and how much working capital will we need to safely operate the business.

In summary, a feasibility study will help the firm avoid the costs associated with making a wrong decision. A basic feasibility study analyzes the factors that directly affect the success of the operation such as: (1) assurance that an adequate market can be secured for the output of the operation; (2) assurance that an adequate supply of quality raw products can be procured at an acceptable price; and (3) determination of facility needs, capital requirements, financing requirements and potential costs and returns from the operation. In short, the analysis of these factors will determine whether or not the venture will be economically sound and make a profitable return for the owners of the firm.

In addition to the analysis of directly influencing factors, a complete feasibility study analyzes the availability of the many facilities and services which the firm feels essential to create an acceptable environment in which the plant can operate and its management and labor force can live; i.e., an analysis of environmental conditions.

<u>Analysis of Environmental Conditions</u>

This phase of the feasibility study concerns itself primarily with the analysis of the general factors affecting where a facility will be located. These are the factors considered after determination has been made relative to the general area of location as affected by supply of raw product and availability of markets; i.e., a vegetable packing plant has decided to locate on the island of Maui and now wants to decide upon the specific city or town to locate the plant. This phase of a feasibility study analyzes the availability of the many facilities and services which a firm feels essential to create an acceptable environment in which the plant can operate and its management and labor force can live.

The following is a brief outline of the type of factors that should be considered in this phase of the analysis:

1. Availability of an adequate specific site in regards to physical characteristics; access to the major production area of the raw product; and the availability of the site at acceptable economic terms.
2. Types of local services available in the community including availability of and rates for electrical power, gas service, telephone service, water and sewer service, fire protection, police protection, medical services, cultural and recreation facilities, postal service, financial services, educational facilities, and vocational training facilities. The degree of consideration given to each of these factors depends upon the degree of utilization that the proposed facility expects to have of the service. For example, if the proposed facility will require importation of

personnel then such factors as recreation facilities, schools, medical facilities and available housing become very important in terms of satisfying the new personnel. If the facility requires certain utilities, then it becomes important to evaluate the availability and rate structure for the use of these utilities.

3. Type and availability of labor required for operation of the facility, which would include an analysis of such factors as a labor profile (education, age, skills, etc.), wage scales, employee turnover rates and absenteeism experienced in the area, unemployed, labor relations history, and labor practices (vacations, holidays, etc.).
4. Type of governmental structure which would include an analysis of assessment policies, types of taxes, tax rates, zoning ordinances, building codes, and pollution and sanitation regulations.
5. Type of transportation facilities which would include an analysis of types of transportation available, adequacy of facilities, record of performance, cost and rates, and regulations or tariffs.

This list is not complete, but does indicate the type of factors that an agribusiness firm should analyze before making a location decision. The specific factors that should be analyzed depend upon the individual needs of the firm.

Summary

Hawaiian agriculture is changing rapidly. To adjust to these changes, farmers and agribusiness firms must constantly search for alternative types of enterprises and/or alternate methods of producing and marketing their products. This search must be done in a systematic and effective manner to insure that alternatives are economically sound before they are selected. A feasibility study is designed to determine whether or not a specific alternative is economically sound and thus should (must) be conducted as part of the analysis of the alternatives.

A complete feasibility analysis analyzes the directly influencing factors including market potential, raw product supply, and the production process. In addition, it analyzes the environmental conditions such as the availability of facilities and services required by the proposed venture. If all of these factors are analyzed adequately and are determined to be favorable for economic operation, the venture should be profitable. However, it should be pointed out that the final profit determining factor is management. The firm must have competent management to follow through the functions of planning, organizing, directing, staffing, and controlling in order to insure a profitable undertaking.

APPENDIX A

CONDUCTING A COMPLETE FEASIBILITY ANALYSIS

A. ANALYSIS OF DIRECTLY INFLUENCING FACTORS

1. Market Determination - determines potential market for the product.

    a. Consumption - analyzes consumption trends of production and competing products and determines form, quality, and volume requirements.

    b. Markets - determines type, location and cost of serving potential markets.

    c. Distribution system - determines type, method and cost of distribution system for the product.

    d. Market entry - determines method and cost of introducing the product to consumers.

    e. Buyers - determines type of buyers, and requirements and costs of selling to these buyers.

    f. Selling arrangement - determines type of selling arrangements including delivery schedules, pricing arrangements, payment schedules, etc.

    g. Prices - projects prices expected for the product.

2. Raw Product Supply - determines economic availability of supply of raw product.

    a. Minimum economic size of controlling unit - cost analysis of existing plants or synthesized models.

b. Plant requirements - determination of quantity of raw product required to support controlling unit.

c. Availability of requirements - determines if required quantity of raw product is available of quality and at acceptable price.

d. Assured supply of requirements - determines if required raw product supply can be assured.

3. Production Process - determines facility needs, capital and financing requirements, and potential costs and returns.

a. Facility needs - determines specific facilities (buildings, equipment, rolling stock, etc.) required.

b. Investment capital needs - determines initial investment requirements for facilities.

c. Labor needs - determines specific quantity and types of labor required.

d. Cost of operation - develops cost budget to include costs of labor and management, raw material, operation and fixed items.

e. Profitability - determines potential profit by estimating returns and comparing with cost budgets. Also includes break-even analysis and preparation of projected income statement, balance sheet, and cash flow statement.

B. ANALYSIS OF ENVIRONMENTAL CONDITIONS

Provides information on potential facility location.

1. Availability of site - determines adequacy of site in physical and economic terms.

2. Availability of services - determines adequacy and cost of required services such as utilities, financial services, educational services, etc.

3. Availability of labor - determines type, cost, and practices of labor available in the area.

4. Governmental structure - determines type of governmental policies in area as they affect operations, such as assessment policies, taxes, zoning ordinances, etc.

5. Availability of transport facilities - determines adequacy and cost of transportation facilities to be used by the firm.

APPENDIX B

A LIST OF FEASIBILITY STUDIES

I. Agricultural Production Feasibility Studies

1. Mollett, J. A. 1963. Cost of Producing Tomatoes in Hawaii. Hawaii Agr. Exp. Sta. Agr. Econ. Rpt. 61.
2. Mollett, J. A. 1963. Cost of Producing Celery in Hawaii. Hawaii Agr. Exp. Sta. Agr. Econ. Rpt. 62.
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II. BUSINESS MANAGEMENT

What is it and why is it important ?

A. COMPONENTS OF BUSINESS MANAGEMENT

1. PLANNING

Planning can take many dimensions. All good planning is useful if it helps to communicate the direction management is attempting to take the business. Our emphasis shall be on the business plan with special emphasis on financial planning.

Businesses who do not make financial plans depend upon their accountants, after the end of the year, to tell management how the business performed. At this late date, the information is of little value for managing the business. For a business to reach its potential, plans must be made and performance monitored on a day-to-day, week-to-week, etc. basis.

2. ORGANIZING

Organizing bring to mind the organizational chart to show how key management relate to each other. However, organizing should extend into all activities of the business. When well done, it considers how all parts of the business relate to their appropriate functions of the business.

3. DIRECTING

Directing refers to the leadership/guiding of the business in the projected direction. It works best when the plans are known by all involved and more leadership than bossing is involved.

4. COORDINATION

Coordination refers to ensuring that all components of the business are working together. This means that the desires of management are communicated down. Just as important is feedback from the bottom up. All departments must be coordinated with each other. For example, production and marketing must constantly stay in communication with each other.

5. CONTROLLING

The name of this function of management does not communicate what it means. Controlling does not mean managing or control of the business. Actually, it measures how the business in performing. Some examples are yield per hectare, tons produced per day, sales per month, etc.

A business has a degree of controlling without a business plan or financial planning. However, management is not nearly as effective without a plan as with a plan.

With a plan, management can rather quickly check to see if the business is on track. Problems can be detected early and the problems can be rectified. If performance is better than expected, knowledge of this can be used to do even better.

B. WHY BUSINESS DO NOT SUCCEED

Many new businesses fail ! Why ?

1. APPARENT REASONS

a. Not enough sales

b. Not enough funds

2. REAL (ACTUAL) CAUSES OF BUSINESS FAILURE

a. LACK OF MANAGEMENT SKILLS

Planning, organizing, directing, coordinating, and controlling.

b. LACK OF EXPERIENCE

May have some knowledge and skills but little or no experience. Experience may be limited or unbalanced. Many new businesses are started by people with production or marketing experience but not both and do not have other experiences needed to be successful. Must recognize this and gain experience quickly or hire people with experience.

c. FAILURE TO PLAN

Under typical, normal conditions, business may succeed. However, must plan ahead for changes in seasonal conditions, for business cycles, for changes in demand, markets, government policy, strategy by competition, etc.

Perhaps many do not make plans because they will discover what they want to do will, not be found to be profitable !

d. FAILURE OF MANAGEMENT TO CHANGE AS THE BUSINESS GROWS IN SIZE.

Management and the stages of growth of the business

1) **Small in the beginning** - The Manager is In an <u>Operator</u> (directly involved in everything - production, finance, marketing, etc.)

2) **Larger** - **The <u>Manager</u>**

Now large enough to hire key management specialists (finance, accounting, production, marketing, etc.) The manager's job is to work with these department managers.

For many new businesses, a very critical adjustment. Must have good management skills to survive this stage of growth. Organizing and coordination of utmost importance. Personnel management comes into the picture. Must correctly identify and describe these new management positions. Staffing and training becomes important.

The manger is no longer directly involved with production and marketing. Duties shift to supervising department heads, involved with planning and setting policy, making financial arrangements and unpleasant duties such dealing with key employees who do not fit in the business.

Often time the manager does not have he skills or interests in this level of business administration. Must find a satisfactory way to shift to this level or the former smaller, highly success business may be in serious trouble.

ECONOMIC NOTE : The volume of business must increase enough to more than offset the added cost of the new layer of management. Normally, business does not change rapidly enough that change from an one-person operator type manager to a second stage management team. Therefore, must constantly be adjusting the job of department heads as more are added.

3) **Mature - The Executive**

The Manager has moved up layers of management to become the executive. The business has been in existence long enough to be well known by its regular customers. Major problem of the executive is to avoid letting the business operate purely on basis of past reputation.

Must have a good research and development department. Must stay abreast of changing desires of customers and shifting strategy of competition. Need to be a good motivator. Important to have the company project a positive image to society. Today this includes being environmentally friendly.

You can probably identify numerous companies in this region who are in trouble because the executive has done a poor job. From the USA we have many good examples Sears who for a long time was our largest retailer, IBM our auto manufacturers, etc. We keep waiting for major flaws to surface in Walmart, our current largest business in terms of volume of sales.

Enough about the negative side of business. For the remainder of the time, we want to occupy our selves with the positive.

C. PLANNING AND CONTROLLING AS THE KEYS TO SUCCESS

We shall put major emphasis on developing a complete business plan. However, our emphasis shall be on financial aspects.

In order to really succeed, you must be a good manager in all respects. However, if you cannot put enough money through the business you will continue to have trouble.

The basic keys to financial success is to make plans and to monitor performance toward these goals. With this as a point of departure, we shall pull financial planning up front before getting into the details of the business plan.

III. FINANCIAL PLANNING

Pulling the financial planning a little out of context is not to diminish the importance of other parts of the business plan. Doing so I think will make the workshop more interesting and meaningful to you.

We begin the process by projecting income (and all other elements of the income statement) for the year ahead. Actually lenders may require the information for 3-5 years ahead.

The annual projected income then must be further estimated on a monthly basis. From the monthly income estimates, we can estimate the initial cash position, cash inflows, cash outflow, and ending cash position.

A. PROJECTING FUTURE INCOME (PROFIT)

We shall closely follow the material in the financial management handout. Note that the process of looking ahead financially is often referred to as budgeting.

B. PROJECTING CASH FLOWS

C. CONTROLLING - CHECKING PERFORMANCE

EXERCISE PROJECTING INCOME

You are in group number ....

Use the appropriate sales (turnover) data for your group and plot on the graph.

SALES FOR GROUPS

	# 1	# 2	#3 ($ '000)	#4	#5	#6
YEAR 1	450	350	200	250	200	250
YEAR 2	400	400	225	300	250	350
YEAR 3	350	450	350	275	325	225
YEAR 4	400	450	425	325	350	350
YEAR 5	450	350	525	350	350	350

Estimate sales for next year (Year 6) ....

Using your sales above for year 5 and the percentages of sales in column 3, calculate the dollar sales for year 5 (column 6).

Using the projected percentage of sales in column 5, calculate dollars projected for the next year (column 7).

Calculate the projected change in dollars (column 8) Column 8 is column 6 subtracted from column 7. How much difference is there in your projected profit for next year compare with last year (year 5)?

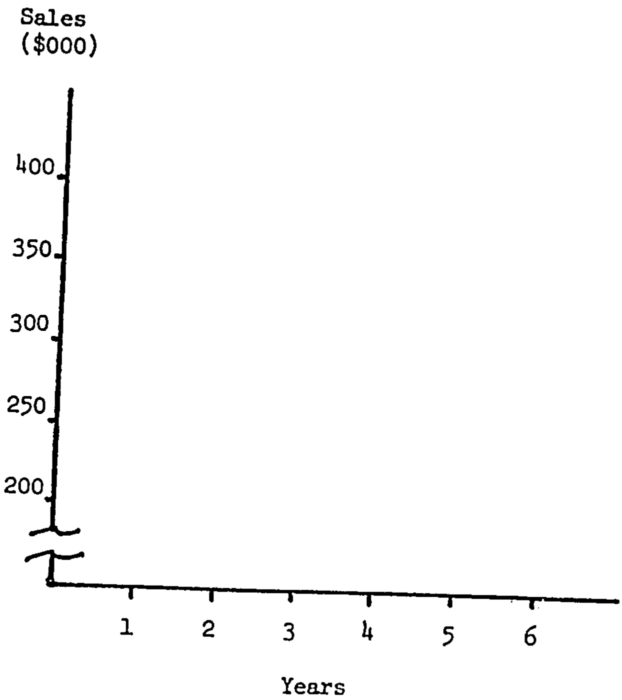

Figure 15.1. Sales for the past five years with projection for the next year.

Table 15.2. Projection of income for the year ahead using past years' income information.

	Col. 1	Col. 2	Col. 3	Col. 4	Col. 5	Col. 6	Col. 7	Col. 8
	----Years[a]----							
Items	3	4	5	Average	Projected	Year 5	Projected next year	Projected change
	---------------% of Sales---------------					--------------dollars-----------		
Sales	100	100	100	100	100			
Cost of Goods	53.76	52.79	51.22	52.60	50.47			
Gross Profits	46.24	47.21	48.78	47.40	49.53			
Expenses:								
Depreciation	2.31	2.61	2.77	2.56	2.96			
Taxes	5.42	5.95	6.21	5.86	6.62			
Salaries	17.39	17.55	17.68	17.54	17.82			
Vehicles	1.76	1.91	1.72	1.80	1.78			
Advertising	1.67	1.79	1.93	1.80	2.06			
Utilities	1.67	1.80	2.51	1.99	2.73			
Supplies	1.40	1.74	2.06	1.73	2.36			
Buying expenses	.69	.74	.47	.63	.63			
Insurance	.69	.65	.72	.69	.74			
Other expenses	1.11	.57	.74	.81	.76			
Total expenses	34.11	35.31	36.81	35.41	38.46			
Profits	12.13	11.90	11.97	11.98	11.07			

[a]/See Table 15.1 for details

MONTHLY CASH INFLOWS

Sales (turnover) are 50% for cash and 50% on credit. Although the terms of the credit is to be paid in 30 days, actually 75% of the previous month's credit sales are received in the following month leaving the other 25% for the second month following sales.

SALES WERE AS FOLLOWING :

	$
NOVEMBER	24,000
DECEMBER	30,000
JANUARY	20,000
FEBRUARY	25,000
MARCH	40,000

	JANUARY	FEBRUARY	MARCH
50%	( )	( )	( ) ....
75%	( )	( )	( ) ....
25%	( )	( )	( ) ....
TOTAL	....	....	....

PROJECTING MONTHLY FLOWS

Using Table 15.6, complete the estimated monthly cash flows for July and August using the same cash inflows percentages from sales as for our previous exercise. For this exercise use the projected monthly income in Table 15.5. Make the assumptions, in July will make loan payment of $ 500 and owner will make personal withdrawing of $ 1,000. In August will make loan payment $ 1,200 and the owner withdraws $ 1,000.
If in either month the cash balance is deficit assume borrowed funds. Insert this amount as other income.

Months

Item	1		2		3	4	5	So on	10	11	12		Total	
	Estimate	Actual	Estimate	Actual							Estimate	Actual	Estimate	Actual
CASH AVAILABLE:														
Cash on hand (Start of month)														
Cash sales														
Collection of accounts receivable														
Other income														
TOTAL CASH AVAILABLE														
CASH PAID OUT:														
Purchases														
Taxes														
Salaries														
Vehicles														
Advertisement														
Utilities														
Supplies														
Buying expense														
Insurance														
Other expenses														
Subtotal														
Loan payments														
Capital purchases														
Reserve and/or escrow														
Owner's withdrawals														
Other (Specify)														
TOTAL CASH PAID OUT														
CASH BALANCE (end of month)														
SELECTED OPERATING DATA:														
Sales														
Account receivable (End of Month)														
Bad debts (End of month)														
Inventory (End of month)														
Accounts payable (End of month)														
Depreciation														

MANAGING MONTHLY CASH FLOWS

Monthly cash flows have been projected as shown. Business has a goal of keeping a minimum cash balance at end of the month of $ 5,000. May borrow when deficit and make short term investments when surplus. Want to minimize interest paid. Complete the Table showing the action to be taken.

COMPLETE THE TABLE SHOWING ACTION TO BE TAKEN

	Projected Cash $	ACTION None	Borrow	Pay Back	Invest	Use Investment	Balance
JAN	5,000						
FEB	4,000						
MAR	-2,000						
APR	9,000						
MAY	12,000						
JUNE	10,000						
JULY	6,000						
AUG	4,000						
SEPT	2,000						
OCT	-2,000						
NOV	-1,000						
DEC	15,000						

FINANCIAL MANAGEMENT

Financial management is the part of the management job where all the numbers have dollar marks in front. Professional managers describe the task of financial management as consisting of planning, checking performance, and analyzing the financial situation. In this chapter financial management is discussed in terms of planning, setting goals and checking performance, and making financial analysis.

Financial Planning

Financial planning consists of projecting the financial situation of the business into the future. The process of estimating the financial situation for future time periods is usually referred to as budgeting. A very important further step beyond the usual budgeting consists of projecting cash flow by months.

Budgeting

The expected future of the business may be projected in terms of the income statement or in terms of the balance sheet. Most budgeting activities, however, are associated with attempting to estimate the future level of income. If a projected balance sheet is desired, it should logically be developed after first projecting the income statement for the period.

The process of projecting profits is a matter of extending past trends for each income and expense item into the future. Sales represent the key figure in the entire estimation process. The standard procedure consists of first estimating sales for the period in question and then estimating all other items in relation to their historical percentage of sales. These percentages for each income and expense item should already be available for past periods as a part of the analysis process. Table 15.1 illustrates income statements for the previous five years analyzed in this fashion.

What will sales be for next year? Several methods might be used to project the future period's sales, but perhaps the most reasonable is to plot the sales on graph paper and to make a conservative extension of the trend in sales.

The process of estimating future sales is illustrated in Figure 15.1. The trend line is fitted to the sales for past years in such a way that each contributes to the location of the line. Once the trend line has been located, it is extended until it reaches the horizontal distance represented by the sixth year which is being estimated. The point on the trend line representing the sixth year is marked and sales are read off the vertical sales scale as $310,000.

The estimated sales taken from the trend line should never be accepted without subjecting the estimate to judgement. Information on recent sales, especially, how sales late in the past year compared with sales for the same months in the year before, should be used to temper the sales estimate from the trend line. A feel for trends in the major product lines as well as overall trends in the general economy may be used to adjust the finally accepted value for sales.

Table 15.1. Income statements for the past five years, in actual dollars and as percentages of sales.

	years									
	1		2		3		4		5	
Item	Dollars	%	Dollars	%	Dollars	%	Dollars	%	Dollars	%
Sales	261,680	100	285,473	100	270,796	100	316,408	100	295,232	100
Cost of goods	138,632	53.32	152,814	53.53	145,580	53.76	167,032	52.79	151,218	51.22
Gross profits	121,368	46.68	132,659	46.47	125,216	46.24	149,376	47.21	144,014	48.78
Expenses:										
Depreciation	7,798	2.98	6,566	2.30	6,255	2.31	8,258	2.61	8,178	2.77
Taxes	13,424	5:13	14,359	5.03	14,677	5.42	18,826	5.95	18,344	6.21
Salaries	40,325	15.41	47,902	16,78	47,091	17.39	55,530	17.55	52,197	17.68
Vehicles	4,920	1.88	4,254	1.49	4,766	1.76	6,043	1.91	5,078	1.72
Advertisement	5,129	1.96	5,424	1.90	4,522	1.67	5,664	1.79	5,698	1.93
Utilities	5,679	2.17	6,081	2.13	4,522	1.67	5,695	1.80	7,410	2.51
Supplies	4,689	1.79	5,424	1.90	3,791	1.40	5,506	1.74	6,082	2.06
Buying expense	2,852	1.09	2,398	.84	1,869	.69	2,341	.74	1,388	.47
Insurance	1,806	.69	2,170	.76	1,869	.69	2,057	.65	2,126	.72
Other expenses	4,370	1.67	4,653	1.63	3,006	1.11	1,804	.57	2,185	.74
Total expenses	90,987	34.77	99,231	34.76	92,368	34.11	111,724	35.31	108,676	37.06
Profits	30,381	11.91	33,428	11.71	32,848	12.13	37,652	11.90	35,338	11.91

BEST AVAILABLE DOCUMENT

PROJECTING NEXT YEAR'S SALES

YEAR	SALES
	$
Year 1	261,680
Year 2	285,473
Year 3	270,796
Year 4	316,408
Year 5	295,232
Next Year	

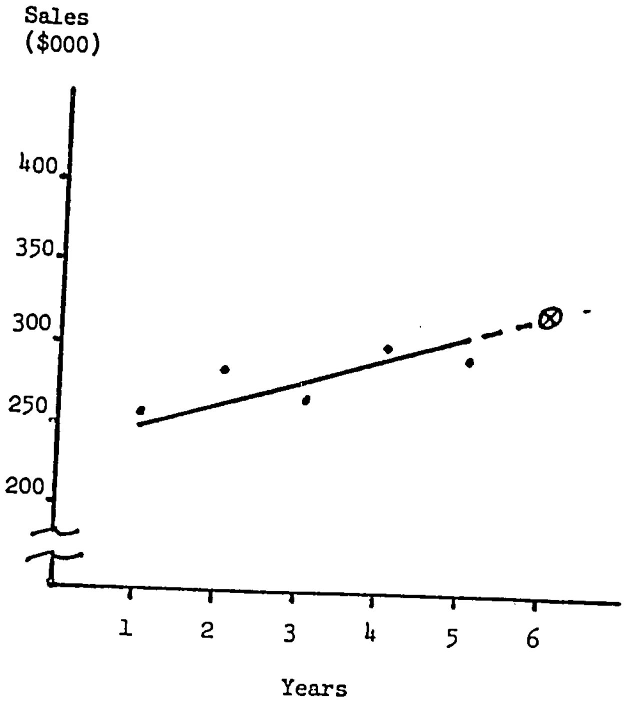

Figure 15.1. Sales for the past five years with projection for the next year.

The next step is to begin arriving at the percentage allocations of each item to be applied to the sales estimate. Probably the more reasonable method is to take a three-year average of each of the percentage allocations for each item (Table 15.2). Rather than arbitrarily applying this average, again judgement should be applied before applying the percentage to sales. Suppose cost of goods has been 48.05, 52.19, and 51.52 percent of sales, respectively, for the past three years, for an average of 50.59 percent. Since the cost of goods was above the average rate for the last two years, a cost of goods estimate of at least 51.50 or as high as 52.00 percent should be used unless there is reason to expect a sizeable improvement for the next year. After arriving at each of the percentages, they should be added and adjustments made until the total adds to one hundred percent.

Next, the percentage for each item is multiplied by the estimated sales to arrive at the dollar estimate for each item. As a final check, the income statement for the past year should be placed side-by-side with the projected values and the differences between the past year and the projected values calculated. The differences, as estimated, can be individually studied as a final check.

Reducing the projected changes to actual dollars in each case should be a familiar basis for serious evaluation of whether the projected items are reasonable. If a particular dollar item appears out of line with what can be considered reasonable, the projected value should be adjusted. After all such adjustments have been made, the items should re-added.

Developing the balance sheet expected at the end of projected period is relatively simple after developing the income statement.

Table 15.2. Projection of income for the year ahead using past years' income information.

Item	Years[a] 3	4	5	Average	Projected	Year 5	Projected next year	Projected change
	% of Sales					dollars		
Sales	100	100	100	100	100	295,232	310,000	14,768
Cost of Goods	53.76	52.79	51.22	52.60	50.47	151,218	156,457	5,239
Gross Profits	46.24	47.21	48.78	47.40	49.53	144,014	153,543	9,529
Expenses:								
Depreciation	2.31	2.61	2.77	2.56	2.96	8,178	9,176	998
Taxes	5.42	5.95	6.21	5.86	6.62	18,334	20,522	12,188
Salaries	17.39	17.55	17.68	17.54	17.82	52,197	55,242	3,045
Vehicles	1.76	1.91	1.72	1.80	1.78	5,078	5,518	440
Advertising	1.67	1.79	1.93	1.80	2.06	5,698	6,386	688
Utilities	1.67	1.80	2.51	1.99	2.73	7,410	8,463	1,053
Supplies	1.40	1.74	2.06	1.73	2.36	6,082	7,316	1,234
Buying expenses	.69	.74	.47	.63	.63	1,388	1,953	565
Insurance	.69	.65	.72	.69	.74	2,126	2,294	168
Other expenses	1.11	.57	.74	.81	.76	2,185	2,356	171
Total expenses	34.11	35.31	36.81	35.41	38.46	108,676	119,226	10,550
Profits	12.13	11.90	11.97	11.98	11.07	35,338	34,317	-1,021

[a] See Table 15.1 for details

BEST AVAILABLE DOCUMENT

Considerable work may be expended without necessarily adding much accuracy to the estimated balance sheet.

Perhaps the easiest method of deriving the balance sheet is to use as a worksheet the three previous balance sheets with a column left blank to be completed for the projected balance sheet. The historical series of balance sheets is présented in Table 15.3. From these data the projected balance sheet presented in Table 15.4 was developed. Current assets may be more-or-less evident trends. If sales have been rising, cash on hand, inventory, and accounts receivable are likely to be rising.

Fixed assets require adjustments. The depreciation estimated in the income statement is subtracted from the appropriate fixed asset items on the previous year's balance sheet. Added to fixed assets are the values of assets expected to be purchased during the year.

Current liabilities are estimated somewhat in the same manner as current assets. If there are installment payments, the value as of the balance sheet data can be calculated exactly since the periodic payments are known. If some of the new assets will be financed on a short-term basis, they should be added.

Fixed liabilities should be relatively simply to project since most items are likely to be mortgages or other such predictable fixed obligations. Those of a flexible nature might well be predicted on the basis of expected income.

The budgeting process serves at least two purposes. First, it forces management to conscienciously consider doing a better job during the coming year. Secondly, the income statement and balance sheet will indicate where the [illegible] is expected to be a year later and how it is.

Table 15.3. Balance sheets for the past five years, in actual dollars and as percentages.

Item	December 31 Year 1		December 31 Year 2		December 31 Year 3		December 31 Year 4		December 31 Year 5	
	dollars	%	dollars	%	dollars	%	dollars	%	dollars	%
ASSETS										
Current										
Cash	2,874	2.0	3,122	2.1	3,576	2.1	4,408	2.5	4,223	2.4
Inventory	22,838	16.4	24,308	16.5	27,713	16.2	31,819	18.1	34,082	19.5
Accounts receivable	4,041	2.9	4,223	2.9	5,879	3.4	8,123	4.6	9,239	5.3
Total current	29,753	21.3	31,653	21.5	37,168	21.7	44,350	25.2	47,544	27.2
Fixed										
Real estate and buildings	97,175	69.7	96,051	65.1	115,319	67.5	113,785	64.6	110,008	62.8
Vehicles	4,018	2.9	9,204	6.2	8,382	4.9	8,079	4.6	7,870	4.5
Equipment and fixtures	8,468	6.1	10,563	7.2	10,004	5.9	9,812	5.6	9,579	5.5
Total fixed	109,661	78.7	115,782	78.5	133,705	78.3	131,676	74.8	127,457	72.8
TOTAL ASSETS	139,414	100.0	147,435	100.0	170,873	100.0	176,026	100.0	175,001	100.0
LIABILITIES										
Current										
Accounts payable	3,019	2.2	3,112	2.1	4,529	2.7	7,804	4.5	6,589	3.8
Notes payable	2,000	1.4	1,500	1.0	---	---	2,000	1.1	1,000	0.6
Total current	5,019	3.6	4,612	3.1	4,529	2.7	9,804	5.6	7,589	4.4
Fixed										
Mortgage (1st part)	25,218	18.1	24,126	16.4	22,817	13.4	21,342	12.1	19,504	11.1
Mortgage (2nd part)	40,543	29.1	38,842	26.3	36,973	21.6	33,945	19.3	31,658	18.1
Mortgage (Lot #3)	---	---	---	---	20,500	12.0	18,000	10.2	16,000	9.1
Total fixed	65,761	47.2	62,968	42.7	80,290	47.0	73,287	41.6	67,162	38.3
TOTAL LIABILITIES	70,780	50.8	67,580	45.8	84,819	49.7	83,091	47.2	74,751	42.7
NET WORTH	68,634	49.2	79,855	54.2	86,054	50.3	92,935	52.8	100,250	57.3
LIABILITIES PLUS NET WORTH	139,414	100.0	147,435	100.0	170,873	100.0	176,026	100.0	175,001	100.0

Table 15.4. Projection of the balance sheet for the year ahead using data from previous years' balance sheets.

Item	December 31 Year 3	December 31 Year 4	December 31 Year 5	Projected December 31 Year 6
	dollars			
ASSETS				
Current				
Cash	3,576	4,408	4,223	4,500
Inventory	27,713	31,819	34,082	36,000
Amount receivable	5,879	8,123	9,239	9,500
Total current	37,168	44,350	47,544	50,000
Fixed				
Real estate and buildings	115,319	113,785	110,008	106,000
Vehicles	8,382	8,079	7,870	7,000
Equipment and fixtures	10,004	9,812	9,579	10,000
Total fixed	133,705	131,676	127,457	123,000
TOTAL ASSETS	170,873	176,026	175,001	173,000
LIABILITIES				
Current				
Accounts payable	4,529	7,804	6,589	8,000
Notes payable	---	2,000	1,000	2,000
Total current	4,529	9,804	7,589	10,000
Fixed				
Mortgage (1st part	22,817	21,342	19,504	17,500
Mortgage (2nd part)	36,973	33,945	31,658	29,500
Mortgage (Lot #3)	20,500	18,000	16,000	14,000
Total fixed	80,290	73,287	67,162	61,000
TOTAL LIABILITIES	84,819	83,091	74,751	71,000
NET WORTH	86,054	92,935	100,250	102,000
LIABILITIES PLUS NET WORTH	170,873	176,026	175,001	173,000

expected to get there. Thus, budgeting helps to set goals. However, to help those responsible for financial matters such as managing operating funds, additional planning is required to develop detailed expectations on a month-by-month basis for the year ahead.

Estimating Cash Flows

In order to make optimum use of operating funds during the year, projections of sales and expenses are needed on a monthly basis. Knowing when income is expected to exceed expenses and vise versa can aid the manager in knowing when bills can be paid and when there are not sufficient funds on hand. A very useful part of the projection process is details on non-periodic bills such as insurance and mortgage payments. With these details, management can decide when to use delayed billing, take trade discounts, save for unusual payments, etc.

In order to estimate the cash flow situation on a monthly basis, the annual projection for the year ahead must be allocated among months (Table 15.5). This monthly breakdown is generally done on the basis of past years' data. In order to make the estimates, the sales for each month during the previous three years are added. Then each of these three-month totals are divided by the total sales for the three years. The resulting figures when multiplied by 100 represents the average percentage of sales occurring each month.

These monthly proportions of sales may be multiplied directly by the projected annual sales to give an estimate of monthly sales. However, some judgement may be applied to the monthly percentages before they are used.

Table 15.5. Projected monthly income for the next year.

Item	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Total for year	Percent of sales
							dollars							%
Sales [a]	14,570	20,460	30,380	39,990	36,270	23,870	22,630	23,870	25,730	22,320	18,600	31,310	310,000	100
Cost of goods	7,275	10,216	15,170	19,965	18,108	11,918	11,299	11,918	12,846	11,144	9,287	15,634	154,800	49.94
Gross profits	7,295	10,244	15,210	20,025	18,162	11,952	11,331	11,952	12,884	11,176	9,313	15,678	155,200	50.16
Expenses:														
Depreciation	767	767	767	767	767	767	767	767	767	767	767	767	9,200	2.97
Taxes	2,070	960	1,350	2,010	2,650	2,400	1,580	1,490	1,580	1,700	1,480	1,230	20,500	6.61
Salaries	2,590	3,640	5,410	7,120	6,470	4,250	4,030	4,250	4,580	3,970	3,310	5,580	55,200	17.81
Vehicles	260	370	550	720	650	430	410	430	470	400	340	570	5,600	1.81
Advertisement	650	300	420	630	830	750	490	470	490	530	460	380	6,400	2.07
Utilities	860	1,100	1,000	560	400	650	650	620	510	620	700	830	8,500	2.74
Supplies	340	480	720	940	850	560	530	560	610	530	440	740	7,300	2.36
Buying expense	100	130	200	260	230	150	150	150	170	140	120	200	2,000	.65
Insurance	-	-	-	-	-	-	-	-	1,150	-	1,150	-	2,300	.74
Other expenses	110	150	240	310	280	190	180	190	200	170	140	240	2,400	.77
Total expenses	6,937	7,477	10,697	13,747	13,647	9,887	8,737	8,977	10,757	8,757	8,637	10,837	119,400	38.53
Profits	358	2,767	4,513	6,278	4,515	2,065	2,594	2,975	2,127	2,419	676	4,841	35,800	11.63

[a] Monthly sales were derived from the projected annual total on basis of the monthly proportion of slaes for the past three years.

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Once the monthly sales have been estimated, the individual items can be estimated using the percentages used on an annual basis. However, the expense items are not likely to occur in exactly the same proportions to sales each month so using the annual proportions will likely inject errors in the individual monthly expense items. For example, items such as depreciation are likely to be more-or-less constant each month unless major depreciable items change. Since taxes are mostly sales taxes for the previous month's sales, the projected proportion of sales which are taxes may be applied to the previous month's sales to estimate a particular month's taxes. Salaries for regular employees are, of course, fixed except for any anticipated adjustments in levels. Normally, seasonal increases in sales are handled by increased use of part-time help. Therefore, salary estimates for slack sale months should not be lower than the expected payroll. Once this level is estimated, the balance of the salary expense can be estimated from the monthly sales.

Advertising costs probably follow the actual expenditure by a month when the bill is paid. Many managers do their advertising in relationship to seasonal sales. Others advertise when sales are expected to be at low levels. The monthly proportions of advertising for past years may be used to allocate advertising expenditures.

Utility expenses normally are greatest during winter and summer months. Actual payment of the bills may lag the use of the utilities.

Insurance, unless paid in monthly installments, will likely come in a few large increments. The previous year's records provide a good basis for allocating the projected annual amount unless changes in unit costs or coverage are anticipated.

The other expense category may contain a few items whose time of payment can be forecast. Mostly this category is a group of miscellaneous items whose amount and item cannot be accurately estimated.

Items such as vehicles, supplies, buying expense, and other expenses can be estimated using the annually projected proportions of sales.

After completing these calculations, some adjustments will be necessary to make the monthly estimates add to give the projected annual totals. Judgement is necessary to bring the subtotals in agreement with the annual totals.

With the monthly estimates of income completed, monthly cash flow projections become relatively simple. A form for recording the garden center's projected cash flows is presented as Table 15.6. Several items require some approximating but most can be taken directly from the income projections. In order to estimate receipts from accounts receivable, the proportion of total sales which will be credit must be estimated. Since the amount of accounts receivable collected in a given month is related to credit the previous month, accounts receivables collected are lagged by one month.

Purchases, of course, proceed sales; however, payment for purchases will roughly match up with sales. Unusual arrangements for payment of purchases such as delayed billing until later in the season must be considered. Estimating the amount of purchases is mostly a matter of estimating the proportion of sales made up by purchases and multiplying this proportion by sales. If unusual arrangements have been made for paying from some purchases, the monthly purchase costs must be reduced

Item	Months: 1 Estimate	1 Actual	2 Estimate	2 Actual	3	4	5	SD	8D		10	11	12 Estimate	12 Actual	Total: Estimate	Total: Actual
CASH AVAILABLE:																
Cash on hand (Start of month)																
Cash sales																
Collection of accounts receivable																
Other income																
TOTAL CASH AVAILABLE																
CASH PAID OUT:																
Purchases																
[illegible]																
Salaries																
[illegible]																
Advertisement																
Utilities																
Supplies																
[illegible] expense																
Insurance																
Other expenses																
Subtotal																
Loan payments																
Capital purchases																
Reserve and/or escrow																
Owner's withdrawals																
Other (Specify)																
TOTAL CASH PAID OUT																
CASH BALANCE (end of month)																
SELECTED OPERATING DATA:																
Sales																
Account receivable (End of Month)																
Bad debts (End of month)																
Inventory (End of month)																
Accounts payable (End of month)																
Depreciation																

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for months of no payment and increased for those months in which the payment or payments will be made.

The next group of items for which cash is paid out is the usual cash expenses. Depreciation, of course, is not among this group because it does not represent specifically a cash outflow. The paid out subtotal then includes the usual expense items contained on income statements less depreciation plus merchandise purchases.

The "cash paid out" items appearing below the subtotal are those not normally considered as expenses to the business but do represent cash outflows. Loan principal payments do not represent an expense to the business. Interest on operating loans does represent a current expense and is included in the expense subtotal. Interest paid may be included as a current expense or may be considered as representing an expense outside the business and handled as a deduction on the owner's income tax return depending upon the legal situation of the business. When comparing the records of the business against those of other garden centers, the latter method is to be preferred. By keeping interest on longer terms loans outside the business, all businesses can be considered on a comparable basis regardless of the amount or debt.

Capital purchases represent the amount to be paid out. If only a down-payment is to be paid, only this amount is included.

The reserve and/or escrow category provides for setting aside or accumulating of funds. Some businesses regularly set aside money to ease the burden of larger payments. Items such as insurance, taxes-including both real estate and income, and major capital purchases may fit into this category. Depreciation written off as an expense may be accumulated in a reserve fund to replace items being depreciated.

The owner's withdrawals represent outflow but not an expense unless the business has been incorporated. In the case of a corporation, the owner's withdrawals generally occur as a salary and is included with other salaries. One purpose of withdrawals is to pay estimated income tax installments. Federal income taxes represent cost to the owners.

Once the monthly cash flow situation has been estimated, plans can be made to make optimum use of funds. Surpluses can be applied to debts, to build up inventories, or if no other productive use can be found for these funds, they can be placed in a savings account to earn interest. If there are expected to be periods of shortages of cash, plans can be made to arrange for loans and plan their repayment.

Checking Performance

Another task of the financial manager is to set goals for the business and check the performance toward these goals. The budgeting and projecting of cash flows in the previous section represent measures of setting standards. Following through the year comparing the actual records with the projections measures performance in those categories.

Many points may be found in a garden center to check performance. Goals may not be specifically set in all cases but past performances may be used for reference points. For example, based on sales projections for a particular month, sales must average $1,000 per day. Each day's sales may be compared with the $1,000 goal, or knowing that the projection of $1,000 per day represents a 10 percent increase above the same month the previous year, sales each day may be compared with sales the same day a year earlier.

The number of places and ways to check performance depends upon the imagination of the person repsonsible for checking it. Some of the more common and/or more important places to check the performance on an economic basis are sales, net profits, gross profits, sales per clerk, size of sale, and number of sales per day.

After holding sales improvement sessions for the sales clerks, the manager is interested in measuring the effect of the training sessions. The best method to do so is to compare the average amount of each sale after the training session with the average amount before. Also, there is interest in checking the effect of major advertising programs. Means must be found to measure the effectiveness of the programs.

Physical goals are set and checked for items such as Easter lillies, Christmas trees, poinsettias, sets of patio furniture, and lawn mowers purchased and sold. Often times physical goals are expressed in terms of units produced per time period.

Other methods of checking selected parts of the business may be both physical and economic. For example, many landscaping departments use a reconciliation system to check each job bidded and installed. An example of a form to check such performance is presented as Table 15.7. The bid is made of an estimate of the materials, professional and landscaping labor, and any other costs expected to be expended on the job. The bid may be given to the customer in an abbreviated form, but the actual inputs on the job are checked back on the same basis as the bid. This procedure checks the ability of the bidder to anticipate all aspects of performing the job. Using this procedure indicates how well the bidder performs each time, and if the deviations in actual performance from the bid are considered too great, the process of continuing to check back should improve the bidding procedure.

le 15.7 Bid and reconciliation for landcaping.

, ____________ Location ____________

e Begun ____________ Date Finished ____________

	Bid		Actual		Difference
		$		$	$
erials					
lants					
eat					
ark, Mulch					
ark, Decor					
ertilizer					
erbicide					
________ other					
________ other					
________ other					
placement					
Subtotal					
ndscaper	Hrs.[a]	$[b]	Hrs.[a]	$	$
Consultation[c] ( )Date @$ ________/hr.					
Design (________)Date @$ ________/hr.					
Supervision & Installation (________)Date @$ ________/hr.					
Check-back (________)Date @$ ________/hr					
bor—@ ________/hr.					
Installation [d]					
Replacement					
Subtotal					
hicles @$ ________/mi	Mi.[e]	$[b]	Mi.[e]	$	$
Consultation & design					
Installation					
Check-backs					
Replacement					
Subtotal					
quipment	Hrs.	$	Hrs.	$	$
________ (Specify) @$ ________/hr.					
________ (Specify) @$ ________/hr.					
________ (Specify) @$ ________/hr.					
Subtotal					
otal	XX		XX		

[a] Account for all time associated with the job. [b] Show on bid sheet as a single figure under labor. [c] Include contact time spent with customer discussing proposed job. [d] Should correspond to time part-time labor is on pay roll. [e] Account for all mileage associated with job.

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One of the more important checks on performance involved pricing of merchandise. Chapter X is devoted to that subject, but from a financial analysis point of view, prices should be analyzed to see if they meet the objective of maximizing profits. As is discussed in detail in Chapter X, not all merchandise can be expected to contribute equally to profits, but costs of operating the garden center should be sufficiently well known that the cost of purchasing and selling each item of merchandise can be estimated to determine whether the pricing objectives are being realized. If manufacturer or supplier suggested retail price or usual trade mark-ups are being used, costs of handling each item for the garden center should be estimated to decide whether the pricing methods are acceptable.

While setting goals and checking performance to determine whether the goals were reached may end in a "yes" or "no", the financial situation requires more detailed analysis.

Financial Analysis

The usual concept of financial analysis consists of the familiar ratio analysis. However, the evaluation of the business should not be limited to the usual ratio analysis alone. Two additional evaluations consist of (1) checking the garden center's financial progress over time and (2) comparing the business' performance against other garden centers. Since ratio analyses can best be described with an example, the other types of analyses are described first and the data used for these two analyses are developed for the ratio analysis.

Comparison Over Time

The data contained in Table 15.1 represent such a historical comparison of the income statements. Often there is a tendency to only compare the dollar change in items over time. Of course, in order to ascertain the relative importance of the business, the actual dollar level of profits is of upmost importance. However, to measure progress toward achieving an efficient business, the percentages of sales provide a better comparative measure over time.

In terms of efficiency the gross profit situation has somewhat steadily improved from 46.68 to 48.78 percent of sales by the fifth year. The increased cost of salaries relative to sales slightly more than offset the efficiency gained in gross margins. The reason for this somewhat rapid rise in the salary category should be carefully considered. Were salaries increased too rapidly? Was too much labor hired? Was it because of minimum wages? Was it because as the business grew the owner-manager had less time to sell and had to replace himself as a clerk as he became more of a manager? Regardless of the reason or reasons, obviously, salaries are a very important item to watch closely because in garden centers salaries rank second only to the merchandise in terms of costs.

All expense items should be carefully examined over time. A savings of one percent of sales in terms of expenses is the same regardless of which expense category from which the savings arises. Some expense items may be expected to decrease in percentage terms as the volume of sales increases simply because of the amount of the total expenditure doesn't change much regardless of sales. If generally the same physical facilities are used over time, depreciation and rent would decrease AS A PERCENTAGE OF SALES as the volume of sales increases. Also, in the example illustrated in Table 15.1, buying expense fell in dollar terms and as a percentage of sales as trade sources became established. Less trips to markets and producers were required, and when travel was incurred, larger orders were placed.

The ratio analysis presents a better evaluation of whether profits are reasonable, but an examination of the change in profits is of some value. Assuming the owner-manager has not been including his drawings from the business in the salary category, the profit category represents his earnings for the value of his labor and management plus the earnings on his money invested in the business. In order to keep the proper prospective, the increased profits should also reflect an increase from any increase in the value of his management and increases in the value of his investment. A stable level of profit over time means the owner is not receiving more for his management and his money invested even though in the latter case he is paying off the mortgage.

Taking this analysis of profits over time further, increasing profits are necessary just to take home the same earning for the owner's management and labor if real estate values continue to rise and if inflation is a factor. Inflation adds another dimension to this problem in that increases in profits because of inflation are taxed at higher rates than if profit levels were lower. Therefore, earnings as measured by profits, should be considered for what they represent and not just in dollar changes from year to year.

Observing the balance sheet over a period of years provides a basis for checking progress (Table 15.3). The key figures are the value of assets, amount owed (liabilities), and the owner's equity (net worth).

Converting the data to percentages expresses the values as a ratio of assets. One of the more often used of these numbers is the percentage of the business which is owned.

Again as for observing the income statements over time, inflation and increasing real estate values should be considered in analyzing the historical balance sheets. Values of assets and liabilities are entered in the balance sheet at the current values at the time of the transaction. After a few years of rapidly rising real estate values, the balance sheet does not realistically reflect asset market values. (Of course, the value of debts remains fixed). For some purposes, valuing assets at current market value is a useful exercise. Two such events in which current market values are needed are for estate planning and when maximum equity is needed for additional financing.

Comparison With Others

Another useful form of analysis is to compare the financial situation for the business under consideration with that of other similar businesses. However, such comparisons should be used with as much information as possible and with the other types of financial analyses. Comparisons are most valid when the garden centers are similar types and volumes of business.

Before comparisons are made, all efforts should be made to insure that comparable accounting procedures have been applied to the businesses being compared. The two places in which the greatest differences are likely to occur in accounting involve the handling of the owner-manager's salary and the charge for the use of the physical facilities. In the latter situation, in one case practically all of the facilities are rented while in the next everything is owned. The solution is to adjust the accounting system to a common method.

Perhaps the more logical system is to add the owner-manager's salary in as an expense if not already included. Regardless, of how much was withdrawn, the amount uses should reflect the value of the contribution made to the business. If other family members worked without compensation, the owner-manager salary should realistically reflect this also.

In order to handle the facilitiy cost problem, those businesses not renting the land and buildings should make a charge reflecting what such rent would be for the real estate being used. This estimate requires an estimate of the current market value of the facilities. Interest paid on mortgages and other long-term obligations should be excluded from expenses. Interest on short-term loans such as those for operating funds is included.

The data for the last year of operation contained in Table 15.1, after being adjusted, are presented in Table 15.8.

Similar adjustments are needed for the balance sheet when not developed on the same basis. Data presented in Table 15.9 represent an adjustment on the balance sheet data for Year 5 showed in Table 15.3. The adjustment in this case represents taking the garden center out of the real estate business.

Now that data have been made available on the correct basis and converted to a percentage to facilitate comparison, the problem is to locate the needed similar information for other garden centers. Garden centers as an identifiable type of business are relatively new compared

Table 15.8. Adjustment of the income statement for Year 5 to reflect payment of owner's salary and to place physical facilities on a rental basis.

Item	Before Adjustment Dollars	%	After Adjustment Dollars	%
Sales	295,232	100	295,232	100
Cost of Goods	151,218	51.22	151,218	51,22
Gross profits	144,014	48.78	144,014	48.78
Expenses:				
Depreciation	8,178	2.77	4,112	1.39
Rent	-	-	12,000	4.07
Taxes	18,344	6.21	16,838	5.70
Salaries	52,197	17.68	52,197	17.68
Owner's salary	-	-	20,000	6.77
Vehicles	5,078	1.72	5,078	1.72
Advertisement	5,698	1.93	5,698	1.93
Utilities	7,410	2.51	7,410	2.51
Supplies	6,082	2.06	6,082	2.06
Buying expenses	1,388	.47	1,388	.47
Insurance	2,126	.72	1,508	.51
Other expenses	2,185	.74	2,185	.74
Total expenses	108,676	37.06	134,496	45.55
Profits	35,338	11.91	9,518	3.23

Table 15.9. Adjustment of the balance sheet for Year 5 to reflect non-owned real estate.

Item	Before Adjustment Dollars	Before Adjustment %	After Adjustment Dollars	After Adjustment %
ASSETS				
Current				
Cash	4,223	2.4	4,223	6.5
Inventory	34,082	19.5	34,082	52.5
Accounts Receivable	9,239	5.3	9,239	14.2
Total Current	47,544	27.2	47,544	73.2
Fixed				
Real Estate and Buildings	110,008	62.8	-	-
Vehicles	7,870	4.5	7,870	12.1
Equipment and fixtures	9,579	5.5	9,579	14.1
Total fixed	127,457	72.8	17,449	26.8
TOTAL ASSETS	175,001	100.0	64,993	100.0
LIABILITIES				
Current				
Accounts Payable	6,589	3.8	6,589	10.2
Notes Payable	1,000	.6	1,000	1.5
Total Current	7,589	4.4	7,589	11.7
Fixed				
Mortgage (1st part)	19,504	11.1	-	-
Mortgage (2nd part)	31,658	18.1	-	-
Mortgage (Lot #3)	16,000	9.1	-	-
Total Fixed	67,162	38.3	-	-
TOTAL LIABILITIES	74,751	42.7	7,589	11.7
NET WORTH	100,250	57.3	57,404	88.3
LIABILITIES PLUS NET WORTH	175,001	100.0	64,993	100.0

with other types of businesses. Therefore, the desirable information for comparative purposes may not be readily available.

If the desirable information is not already available, a systematic search of the state Cooperative Extension Service of the land-grant university, the ornamental horticulture department of the agricultural experiment station of the land-grant university, state trade associations, and the various trade magazines should provide some help. The Small Business Administration may provide some help. The SBA's Ratio Analysis for Small Business bulletin which is updated from time-to-time describes some specific possibilities.

Some progressive garden center managers work out arrangements with managers of similar type and size businesses in other cities to compare financial data and other information. Possibilities for trading information is limited only by imagination of those involved. Some business groups furnish financial information to a third party such as a member of the Cooperative Extension Service staff who calculates averages or in some cases simply codes the individual business data so all remain unidentified.

Some of the above type comparisons are in the form of ratios. Ratios are calculated for comparison over time for the particular business and for comparison among businesses. However, ratio analysis generally extends the evaluation process further than suggested to this point.

Ratio Analysis

Financial ratios provide a shorthand means of communicating information about a business. Ratios can provide valuable insights into a business but should not be relied upon alone to evaluate the business.

A single set of ratios may be of little value in themselves, but as they become available over time and ratios are made available for similar businesses improves their value.

Financial ratios are classified by their sources of data. First, balance sheet ratios indicate how the business stood at a given point in time. Second, income statement ratios indicate the results of operating the business for a period of time. Third, are those ratios composed of items from both the balance sheet and the income statement.

There is no uni ersal agreement amo ng the experts on which ratios to use in a financial analysis. The ratios which follow, however are among the most widely used.

The more popular balance sheet ratios indicate how the business can meet current obligations and the proportion of the business owned. The first has to do with working capital - the difference between current assets and current liabilities. The question being raised is, how the business would settle up if current debts must suddenly be paid. The ratio between these items is referred to as the current ratio :

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

$$= \frac{\$\ 47{,}544}{\$\ 7{,}589} = 6.3$$

Some would argue that the inventory might have little immediate value, so inventory should be omitted. This modification is :

$$\text{Acid -test ratio} = \frac{\text{Current assets - inventory}}{\text{Current liabilities}}$$

$$= \frac{\$\ 13{,}462}{\$\ 7{,}589} = 1.8$$

This ratio implies that the owner's capital is tied up in fixed investments such as real estate and equipment.

Many consider a current ratio of 2:1 as a minimum acceptable level. Others would argue that some inventories cannot be readily converted to cash to settle immediate debts, thus, the need for the acid-test ratio. If the items left in current assets after removing inventory and other slow moving items are readily marketable, a 1:1 acid-test ratio is acceptable.

For long-term questions, solvency ratios are calculated. Holders of debts are more interested in questions of what proportion of the business is owned. These measures indicate how the lender would fare in the event of business failure.

The ratios might be expressed in a number of ways but perhaps the more straightforward is:

$$\text{Solvency} = \frac{\text{Net worth}}{\text{Total assets}}$$

$$= \frac{\$100,250}{\$175,001} = .57 \text{ or } 57\%$$

The 57 percent represents ownership of the total assets.

An alternative is:

$$\text{Solvency} = \frac{\text{Total debt}}{\text{Net worth}}$$

$$= \frac{\$\ 74,751}{\$100,250} = .75 = 75\%$$

Thus 75 percent of net worth is owed to others.

Still another measure of solvency is the relationship between fixed assets and net worth:

$$\text{Solvency} = \frac{\text{Fixed assets}}{\text{Net worth}}$$

$$= \frac{\$127,457}{\$100,250} = 1.27 \text{ or } 127\%$$

Actually the percentages as a proportion of sales contained in Table 15.5 are ratios from the income statements. Expressing items from the income statement as a percentage of sales is a popular method for analyzing a businesses' performance over time and in relationship to others.

The most popular of these ratios is the one which measures net profit :

$$\text{Net profit} = \frac{\text{Net profit}}{\text{Sales}}$$

$$= \frac{\$\ 35{,}338}{\$\ 295{,}232} = .119 \text{ or } 11.9\ \%$$

Another often calculated income statement ratio is the gross profit or gross margin as it is often called as a percent of sales :

$$\text{Gross profit} = \frac{\text{Sales - cost of goods}}{\text{Sales}}$$

$$= \frac{\$\ 295{,}232\ -\ \$\ 151{,}218}{\$\ 295{,}232} = .488 \text{ or } 48.8\ \%$$

Similarly, other items are expressed as a percentage of sales.

Two of the other more commonly used ones for garden centers are salary and advertisement costs :

$$\text{Salary cost} = \frac{\text{salary expenses}}{\text{sales}}$$

$$= \frac{\$\ 52{,}197}{\$\ 295{,}232} = .177 \text{ or } 17.7\ \%$$

$$\text{Advertising cost} = \frac{\text{advertising expenses}}{\text{sales}}$$

$$= \frac{\$\ 5{,}698}{\$\ 295{,}232} = .019 \text{ or } 1.9\ \%$$

Acceptable income statement ratios are often tossed around as if they are firm values which must be met in order to be successful.

However, the circumstances behind the scene must be known before interpreting the ratios. For example, suppose one garden center produces its bedding plants, purchases foliage plants for growing out, and plants its hanging baskets. Another garden center purchases all its plant materials ready for sale. The first business will likely show a relatively high gross profit but also a high salary cost. The second garden center will tend toward a lower gross profit and lower salary cost.

Often recommendations are made on advertising expenditures in relation to sales. Generally, these recommendations are for advertising to consist of 2-3 percent of sales or more. No consideration is given to differences in the cost of advertising among different locations. With wide differences in advertising rates, the same number of dollars purchases wide differences in public exposure.

Some of the more useful ratios require data from both the income statement and the balance sheet. Perhaps the best measure of profits or returns on investment is the ratio of profits to net worth:

$$\text{Profit on equity} = \frac{\text{Profit}}{\text{Net worth}}$$

$$= \frac{\$\ 35,338}{\$100,250} = .352 \text{ or } 35.2\%$$

If profits do not include a charge for the owner-manager and other unpaid family labor, the above ratio should be adjusted:

$$\text{Profit on equity} = \frac{\text{Profit - charge for owner's labor}}{\text{Net worth}}$$

$$= \frac{\$35,338 - \$20,000}{\$100,250} = .153 \text{ or } 15.3\%$$

The 15.3 percent represents the ratio of earnings on the owner's investment in the business and can be compared directly to alternative rates of returns which might be earned. Thus, the measure appears to be the perfect measure of profits; however, if asset market values are substantially different from the accounting values on the financial statement, a more meaningful ratio can be obtained after adjusting net worth to current market values. All of the above measures are dependent upon interest on long-term debt not being included among expenses.

Another ratio used for comparative purposes is average inventory turnover. The calculation may be made from several balance sheet items, but sales and an estimate of the average inventory over the period covered by sales is as good as any. For example, the average inventory to go with sales for Year 5 from Table 15.1 is derived from ending inventories for Years 4 and 5 of $31,819 and $34,082, respectively, from Table 15.3.

$$\text{Inventory turnover} = \frac{\text{Sales}}{\text{Average inventory}}$$

$$= \frac{\$295,232}{\$\ 32,950} = 9.0 \text{ times}$$

The ratio is for comparative purposes and is not intended to measure physical turnover.

Another method of checking the efficiency of working capital involves the average collection period on credit sales. Several methods may be used to make the estimate. One method estimates average daily credit sales and divides this number into the average amount of accounts receivable during the year:

$$\text{Average daily credit sales} = \frac{\text{Credit sales for year}}{365}$$

$$= \frac{\$95,000}{365} = \$260$$

$$\text{Average collection period} = \frac{\text{Average accounts receivable}}{\text{Daily credit sales}}$$

$$= \frac{\$8,681}{\$260} = 33.4$$

The figure represents the number of days that credit sales are tied up before being received. This figure should be compared with the garden center's policy on credit to determine whether the 33 days is good or bad.

Summary

The financial management part of the overall management role involves having a finger on the pulse of those numbers which involve money. At least three specific activities can be identified as fitting into this category: (1) budgeting or planning ahead which includes projecting cash flows, (2) setting standards and checking the performance of the business, and (3) analyzing the business' finances.

The individual responsible for financial management should guide the development of projected income statements and balance sheets for at least the year ahead. Then, to most efficiently use operating funds, these projections should be continued to produce an anticipated cash flow statement for the months ahead.

The financial manager is in the position, as projections are made, to set financial goals for the business. These goals or objectives are stated in a manner such that over time performance can be measured to determine if the goals were achieved.

Finally, comes the financial analysis. The business' progress can be measured in many ways, but perhaps, three of the more meaningful methods are in terms of (a) comparing the garden center's records over time, (b) comparing its performance with other similar size and type of garden centers, and (c) computation of financial ratios for the usual analysis.

IV. DEVELOPING A COMPLETEBUSINESS PLAN

For this section we shall follow very closely the excellent publication on writing business prepared by Djordjija Petkoski and Steven R. Dimitriyev for the world Bank.(copy included in your hand out).

A. REASON FOR THE PLAN

B. ELEMENTS OF THE BUSINESS PLAN

EDIFP
World Bank

Series on Enterprise Management Restructuring and Privatization in the Former Soviet Union

Background Note: How to Write a Business Plan

by
Djordjija Petkoski and Steven R. Dimitriyev

Abstract

This background note is one in the Series on Enterprise Management for Restructuring and Privatization in the Former Soviet Union (FSU). Although it is primarily intended to provide a broader theoretical context for the case studies on enterprise management in this series and to facilitate their use in training, it also provides a detailed guideline on how to prepare a business plan. It can be easily adapted to specific applications depending on the size and nature of the business. The note addresses some of the key issues in business planning and how to write a business plan: a description of the business/company, industry analysis, market analysis and strategy, operations/production plan/manufacturing/research and development, management of the organization, assessment of the risk and financial plan (financial statements and prospectus). This note can be used in connection with *Data Collection Forms: Packet for Business Planning* which is also published within this series.

Contents

Foreword

In late 1991, the Economic Development Institute (EDI) initiated a program as a part of a World Bank effort to assist the republics of the FSU in the process of transition from a centrally-planned economy to a market economy. EDI's strategy in the FSU has been to train trainers in a few areas considered critical during the transition. This background note is one in the Series on Enterprise Management for Restructuring and Privatization in the Former Soviet Union (FSU) produced in tandem with the EDI trainers program by the same title.

Enterprise reform is an integral part of overall macro-economic reform and a prerequisite for private sector development and for developing an efficient and competitive market. The objective of the reform is to transform enterprises into profitable companies that can compete in the domestic and international market. Under these conditions it is necessary for enterprises to thoroughly review business strategy, ownership, corporate structure, managerial styles, financial structure, and other key managerial issues.

The Trainers' Program on Enterprise Restructuring and Privatization was designed to address these needs and included participants from training institutions, privatization agencies, and enterprises. Its purpose was to generate indigenous training capacities in the FSU within a relatively short period of time. The participation of enterprise managers provided operational feedback on the relevance of the training materials and topics covered, and made possible the development of case studies of their enterprises.

The program's objectives were:

(a) to strengthen the capabilities of management training institutions to (i) develop and implement training programs in privatization and corporate management, (ii) provide consulting services for restructuring and privatization, and (iii) prepare case studies for training;

(b) to provide trainers with a set of practical skills in enterprise financial and organizational analysis for restructuring and privatization; and

(c) to introduce the role of business planning and strategy in assessing the restructuring and privatization options for an enterprise.

Intensive work on <u>cases</u> linked to participating FSU enterprises was of critical importance to opening the dialogue among everyone involved in the transition – officials, academics, and managers. The cases developed are significant because they were taken from the reality of the FSU experience. Participants developed case studies from their own enterprises at the start of the training program and then updated them throughout the program. This provided continuous feedback on the relevance of the theoretical topics delivered and a necessary framework for absorbing new concepts.

Although this background note is primarily intended to provide a broader "theoretical" context for the case studies on enterprise management in this series and to facilitate their use in training, it also provides a detailed guideline on how to prepare a business plan. It can be easily adapted to specific applications depending on the size and nature of the business. The note addresses some of the key issues in business planning and how to write a business plan: a description of the business/company, industry analysis, market analysis and strategy, operations/production plan/manufacturing/research and development, management of the organization, assessment of the risk and financial plan (financial statements and prospectus). This note can be used in connection with *Data Collection Forms: Packet for Business Planning* which is also published within this series.

Dr. Djordjija Petkoski is an Enterprise Restructuring Specialist in the Finance and Private Sector Development Division of the Economic Development Institute of the World Bank. Dr. Petkoski directed the program for Enterprise Management for Restructuring and Privatization in the FSU. Mr. Steven R. Dimitriyev is an industry consultant. The opinions expressed in this document are those of the authors and are not necessarily those of the World Bank.

We wish to thank Ms. Lisa Griffih, Editorial Consultant, who contributed greatly to the completion of this work.

Xavier L. Simon
Chief
Finance and Private Sector Development
Economic Development Institute

March 1994

1. Introduction

No enterprise can operate profitably in a market economy without a carefully prepared business plan. The business plan explains in convincing detail how the enterprise's management intends to manage the business so that it will produce acceptable rates of profitability and returns on investment. In addition, because the plan requires constant evaluation and refinement to reflect changing conditions, there must exist a process within the enterprise that involves a broad mix of management personnel in the ongoing development and revision of the business plan.

The need for a business plan is two-fold and its beneficiaries are both external and internal to the enterprise's operations. On the external side, a properly developed business plan can justify confidence of investors and creditors in management's capability to represent their interests competently, thus deserving their financial and strategic support. Conversely, the absence of a well-thought out business plan and regular planning process is considered a vital deficiency of an enterprise and reflects poorly on its management, which in turn complicates the enterprise's ability to attract financial resources and achieve long-term viability in a competitive environment.

The value of the business plan, however, is not limited to convincing investors, owners, and creditors that the enterprise has a clearly defined strategy for success and deserves their support. It is of particular value to the management personnel themselves, for whom the plan serves as the reference for all future strategic directions and activities in support of the goals of the enterprise. The business plan contains very clear definitions of the goals of the enterprise and how they are to be achieved over time. Furthermore, the business plan serves as the foundation for planning and control mechanisms used to manage the day-to-day operational and financial activities of the enterprise.

In brief, the business plan is the critical starting point and basis for all other planning and execution activities of the enterprise. It is the single most important accumulation of strategic information and management direction affecting the future performance of the enterprise, and it describes the rationale for actions undertaken in pursuit of profitability. It is expected that all subsequent budgetary, operational, and investment behavior within the enterprise must be directly traceable to the guidelines and strategic intent outlined in the business plan.

Finally, it is worth emphasizing the following points:

First, it should be clear that the business planning itself is in fact a test of the management's knowledge and understanding of the overall business environment and marketplace in which the enterprise operates. By forcing management to consider specific characteristics and factors influencing the competitive capabilities of their enterprise, the business planning process serves to alert management to any deficiencies in its own capabilities. Thus, the discipline required in developing good business plans contributes to the self-education of management and the creation of effective management strategies.

Second, the work involved in business planning is significant. However, once a plan is produced, subsequent plans require less upfront data collection since much of the historical and descriptive data can be carried over from one version of the plan to another.

The value of the business plan depends on the quality of the information it contains and the validity of any assumptions made. It is critical that the plan be prepared with an objective, open mind and not reflect exaggerated or biased views of reality. While a well-prepared business plan is also a highly effective marketing tool, it must strive to prove to be credible and useful. Its credibility over time is directly indicative of the competence of the enterprise management, which is an issue of prime importance and is closely scrutinized by investors.

2. The Mechanics of Business Planning

Successful company managers must deal effectively with constant change. Planning should be an important part of any business operation. Good planning helps guide the company more steadily through a rapidly changing environment. In a number of companies, even in market economies, real planning is not always fully accomplished. There has been a tendency among many company managers to avoid planning. The reaction often is that planning is dull or boring and is something only used by large companies. This may be an excuse and what is often believed to be the real truth is that some managers are afraid to plan. In most cases, either management believes they can effectively run the company without the formal development of a business plan, or the planning process becomes bogged down in bureaucracy. The fact is that few company managers are really interested in being intimately involved in planning, for they realize that planning is a time-consuming function for which they believe they are poorly qualified. Without good planning the company is likely to pay an enormous price. For example, employees will not understand the company's goals and how they are expected to perform in their jobs.

Planning in a large company is different from the planning needed in a smaller company.[1] Regardless of size, each company should identify its strengths and plan to capitalize on its advantages. The planning should be unique to the company. It must be based on the careful analysis of all aspects of the business. The objectives of the company should be stated in terms of specific results, and plans must be measured and reviewed against timely and accurate management information, such as operating results, product and customers' profitability, inventory and receivable positions, etc.

The process of business planning is also a company self-appraisal activity. It is this assessment aspect of business planning that makes the planning process so important for any ongoing operation. It should be performed on a regular basis, even when attracting additional financing is not a factor.

[1] For example, a smaller company's planning is much more susceptible to the impact of marketing and manufacturing variations. On the other hand, the smaller company is probably more flexible and can be more responsive to shifts in customer needs, the economy, and other variables. Smaller companies usually should strive to excel in short-term planning.

The company self-appraisal, for example, may be performed in conjunction with establishing an operations budget for the coming year. In conducting a company self-appraisal, the following questions should be answered:

- What business is the company really in?
- What skills in the company are valuable and unique?
- What is the company's position in the industry?
- What is the nature of the company's markets?
- What customers is the company serving? Where is the market?
- What market share does the company want? When?
- How do major customers view the company?
- What image changes would be desirable?
- What major changes are likely:
    - in the company's present products and services?
    - in the technology of the industry?
    - in the nature of the competition?
- What, if any, plans should the company have for product improvement?
- What are the company's greatest strengths?
- What are the company's greatest weaknesses?
- What are the company's objectives for product improvement?
- What business does the company want to be in, in three to five years?
- Will the company's objective require capital expenditures?
- How can the company finance growth?
- What specific steps does the company need to take to achieve its objectives?

As a result of the management assessment, the objectives of the company may be more clearly defined and stated. Also, the appraisal and planning process should put the company in a position to better summarize strategies and tactics that will enable it to reach these objectives. Realistic and specific goals should be set for all functions of the business and should be based on industry, market, and company analyses.

Before developing a business plan for a completely new project it is advisable to first prepare a preliminary feasibility study on the project. Does it look reasonable? If yes, then some additional research should be done and a full feasibility study prepared. If the company goals are met, the next step is to develop a strategic plan designed to achieve the goals set. The plan ought to include strategies for all relevant functions of the business. This is very important because the implementation plans should be developed and coordinated across functions and tied to projected completion dates.

In determining the operating strategies in achieving new objectives, the following questions should be answered:

- What will be the effect on the current organization?
- Is a new business something that will support the company's mission? Is being "in this business" appropriate for the company?
- Is the company ready to take on a new project?

- Does the company have the proper management, or must it recruit?
- What is the likely impact—short-range and long-range—on the financial statements? Can the company afford this course of action?
- Can the company invest the time and money needed?
- Can the company raise the necessary funds for implementation? How much will be needed? When?
- Does this strategy utilize the company's strengths and minimize its weaknesses?
- How will the company let the employees and shareholders know?
- Will the Board go along with the idea?
- Are the Board and the staff on the same wavelength when it comes to risk?
- What will be the reaction of the company's bankers, stockholders, customers, and community?
- What is the probability of success, and what must the company do to improve its chances?
- What is the risk of doing nothing?
- How long will implementation of the operating strategies require, and what will be the results?
- In what ways can the risks be minimized?
- What if things go wrong?
- When is the break-even for the products and/or services?
- What would be the impact of outside forces such as changing customer demand, recession, government regulation, labor unrest, and competition?
- When should the plan be reevaluated for possible revision?

2.1 Business Planning Team

The list of important questions goes on and on. It is critical that the company form a group, i.e. a business planning team, to examine these important issues and report to the Board. The team should include some or all of the following people:

- The CEO. The business planning team needs the head honcho. Even if the chief executive officer does not do the actual writing, he or she must be involved in the process.
- The CFO. The chief financial officer (finance manager, or any other title) needs to be involved. Having a talented "numbers" person in the group who can easily foresee the financial implications of management decisions is essential.
- Human resources management people are the key to the overall success of the company. Therefore, a human resources management expert needs to be in the group.
- Board President. If the company has a board of directors, there is no substitute for having the head board person on the team. The company needs the president's acceptance to make the implementation of the project successful.

"The Company Banker." If the company will need a loan, it is prudent to involve the company banker in the project early. The company will get good advice and increase the banker's ownership of the project, which may facilitate loans later.

Putting together a skilled group is one of the most important first steps in business planning. By using such a team, the company will come up with a better plan, lower risk, and increased chances of overall success.

The business plan or some parts of it should be widely distributed for comments. Depending on the type of business, people with other skills (marketing, procurement, public relations, direct sales, labor, legal, and technical skills) can be added to the business planning team. Other outsiders could be added on an *ad hoc* basis if there is need for them; the process is a dynamic one and no one can predict all the needs up front. The group should set deadlines. The project should not be left up to the group. A lead person should be assigned who will be responsible for keeping the group on task, and a designated writer for the feasibility studies and the business plan.

In organizing the business planning team, it is important to consider the following point. With the obvious exception of the external resource, team members must be people with the authority and responsibility for implementing and updating sections of the plan. They need to feel complete ownership of the sections that they influenced or created. They should also be accountable for future performance in terms of achieving the goals in the plan. A business plan has little chance of success if the people participating in its development are not the same people responsible for its implementation or are too far removed organizationally to be in full control of its implementation. For that reason, it is advisable that the team include management representatives of all key functions of the organization. Furthermore, it is to be understood that the same people will be expected to provide timely reports to the chief executives on the status of implementation and achievement of goals of the plan.

2.2 Updating the Plan

The plan should be updated regularly. The most effective business plan can become out of date if conditions change. Environmental factors such as the economy, customers, new technology, and competition, and internal factors such as the loss or addition of key employees can change the direction of the business plan. Thus, it is important to be sensitive to changes in the company, industry, and market. If these changes are likely to impact the business plan, the management should determine what revisions are needed in it. Variance from the plan should be understood and evaluated and factored into management's understanding of its marketplace. In this manner, the manager can maintain targets and goals that are reasonable and maintain the business on a course that will increase its probability of success.

In order to do this, an effective information system is needed. Many businesses suffer from a lack of management information. For example:

- Timely operating statements and balance sheets are often lacking;

- Inventory records can be lacking or inaccurate;
- Tracking of waste, product shrinkage, and inventory losses may not be in place;
- Product-cost accounting may not exist or may be out-of-date;
- Aging of receivables may be prepared late and not reviewed by corporate management; old charges and credits based on such agings may hinder clear analysis of receivables and potential losses; and
- Profitability by plant, office, key customer, and product may need to be determined and tracked.

The fact that business plans are expected to be reviewed and adjusted as conditions change does not absolve management from having to demonstrate its ability to anticipate and assess these changes ahead of time. The difference between strong and weak management is often found in its ability to foresee changes in conditions and the ability to make correct strategic decisions based on insightful predictions.

2.3 Typical Sources of Information in Market-Economies

- Small Business Administration
- Department of Commerce
- Federal Information centers
- Bureau of Census
- State and municipal governments
- Banks
- Chambers of Commerce
- Trade associations
- Trade journals
- Libraries
- Universities and community colleges

3. Business Plan

A meaningful business plan and financial forecast are vital to any business, both as management tools and as instruments to raise the necessary capital and financing. The business plan is not only useful to the company management as a planning document but is also an important tool for obtaining financial resources from bankers, venture capitalists, and other investors. Regardless of the financing method or the type of capital to be raised, virtually any lender, underwriter, venture capitalist, or private investor will expect to be presented with a meaningful business plan. Therefore, business plans are prepared for both internal and external use. For internal use, business plans also are prepared regularly by well-managed companies as a management tool. For external use, business plans are prepared as a necessary part of: a) raising capital from potential investors, bankers, and other lenders; b) "going public;" or c) a private sale of all or part of the company because it helps determine the viability of the business in a designated market. It not only tests the validity of the business opportunities but is employed to obtain financial resources from banks and private and professional investors. It will provide potential investors and lenders with detailed information on all aspects of the company's past and current operations and provide future projections.

For the company management, the plan helps define objectives and keep the business on target. It provides guidance to the management in developing, organizing, and implementing business activities. Preparation of the business plan provides the company management with the chance to test the consequences of different marketing, financing, and management strategies and to perform sensitivity analyses on key assumptions. The business plan should demonstrate that management is committed to and understands its business and it should be based on a set of common, well-researched facts and assumptions. More precisely, it serves as a guide during the lifetime of the business. It is the blueprint of the business and will provide management with the tools for analysis and change.

The business plan should be prepared in order to validate the feasibility of the business opportunity in a timely manner. The business planning process also provides a self-assessment of the top management. Usually, they think that the new business is assured of success. However, the planning process forces them to bring objectivity to the idea and reflect on such questions as:

- Does the idea make sense?
- Will it work?
- Who are the customers?
- Does it satisfy customer needs?
- What kind of protection can the company get against imitation by competitors?
- Can we manage such a business?
- Whom will we compete with?

In this process, the management will be required to play out various scenarios and consider obstacles that might prevent the new business from succeeding. The acting out of these scenarios allows the management to confront these obstacles and plan ways to avoid them. It may even be possible that, after preparing the business plan, the management realizes the obstacles cannot be avoided or overcome. Hence the new business activities may be terminated while still on paper. Although this certainly is not the most desirable conclusion, it would be much better to terminate the business endeavor before investing further time and money, than failing. The process of explaining and justifying financial projections will require an evaluation of all aspects of the business and will serve as a review of all potential problems. The forecast answers such critical questions as when the company will need the money, how it will be used, and how it will be repaid. Even if some of the information is based on assumptions, the thinking process required to complete the plan is a valuable experience for the managers since it forces them to assess such things as cash flow and cash requirements. In addition, the thinking process takes the company into the future and considers important issues that could impair the road to success. Therefore, the planning process also can serve as a valuable exercise that should increase the chances of success of the business.

The plan demonstrates the viability and potential of the business, as well as management knowledge and understanding of the variables necessary for successfully attaining corporate objectives. It also provides the financier with a basis upon which to evaluate both the potential for return on the investment and the individuals who will manage the business. Potential investors and lenders are very particular about what should be included in the business plan. Since the business plan is the first manifestation of management capabilities that the investor sees, it is important that it be carefully prepared.

The depth and detail in the business plan depend on the size and scope of the business. A company planning to produce and market a new portable computer will need a much more comprehensive business plan, largely because of the nature of the product and market pursued. On the other hand, an entrepreneur who plans to open a retail video store will not need the comprehensive coverage required by a new computer manufacturer. Thus, differences in the scope of the business plan may be dependent on whether the business is a service, involves manufacturing, or is a consumer good or industrial product. The size of the market, competition, and potential growth may also affect the scope of the business plan.

4. Business Plan Structure

The following pages provide a suggested outline of the material that should be included in a business plan. In raising capital from third parties, such as venture capitalists or an investment firm, who may have had little or no previous contact with the company, a formal business plan is the company's calling card. A principal purpose of a business plan when raising capital is to get the proposal read, so that the managers can take the next step.

A business plan is unique to the company and, accordingly, the approach used and structure of plans varies considerably depending on the nature of the business, the specific purpose of the plan, and the individual requirements of the lender. A plan for a regional manufacturing firm would include different topics than a plan for a local service establishment. A plan aimed at attracting financial resources might differ in emphasis from an internal document that management will use as a guide for implementation. Regardless of form, however, certain basic questions should be addressed concisely and closely in considering the plan:

- What is the company's business? While this may seem obvious, many plans fail to tell the reader up front what business it's in, and with some plans the reader is never certain.
- What are the company's objectives?
- What are the strategy and tactics that will enable the company to reach those objectives?
- How much financial and other resources will the company need, over what period and how will those funds and resources be used?
- When and how will the money be paid back to the lenders and investors?

Certain caveats apply to all business plans. The following are certain "do's" and "don'ts" to consider when preparing a business plan:

- It should be brief, but it should include everything important to the business. A proposal of seven to ten typewritten pages, double spaced, is often ideal. However, in some cases more detailed business plans are required, exceeding fifty typewritten pages. In any case, secondary issues and information should not be included in the business plan. However, they should be prepared for later discussion.
- Highly technical descriptions of products, processes, and operations should be avoided. Layperson's terms should be used. The business plan should be kept simple and complete.
- The plan ought to be an honest analysis based on realistic assumptions. The assumptions and projections should be well-researched and documented by reference to sources such as market surveys, industry data, economic and population studies, and commitments of those who will do business with the company. Few investors or lenders will risk funds based on unsupported or unrealistic plans. The business plan shows investors and lenders the quality and depth of the company's leadership and indicates management's ability to reach their stated goal. These factors lie at the heart of the decision to invest in the company.
- The company's business risks should be discussed. The company's credibility can be seriously damaged if existing risks and problems are discovered by outside parties on their own.
- Vague or unsubstantiated statements should not be made. For example, statements like "the sales will double in the next year" or that "a new product line will be added" should be avoided. More specific explanation is necessary. The statements should be substantiated with underlying data and market information.
- The plan should be comprehensive and include discussions of the organization's strategies for taking advantage of unexpected opportunities and for overcoming potential difficulties.
- Business plans and budgets for internal use are more detailed that those presented to external users. Accordingly, internal documents should be summarized and properly structured to facilitate review by outside parties.
- The business plan should be enclosed in an attractive but not overdone cover.
- Extra copies of the plan should be provided to speed the review process.

Preparation of a business plan is a time consuming activity and the length of time needed depends on the type of business and the experience and knowledge of the managers. It should be comprehensive enough to give any potential investor a complete picture and understanding of the business activity. It will also help the manager clarify his or her thinking about the business.

Many managers incorrectly estimate the length of time that an effective plan will take to prepare. Once the process has begun, however, the manager will realize that the length of time and commitment are immense but that the process is invaluable in sorting out the business functions of the company.

5. Cover Sheet - Introductory Page

This is the title page of the business plan. It should contain the following:

- Name of the company
- Company address
- Company phone numbers
- Names, titles, addresses, phone numbers of owners/principals
- Paragraph describing the company and the nature of the business
- Statement of financing needed. The company may offer a package, that is, stock, debt, and so on. However, many venture capitalists prefer to structure this package in their own way.
- A statement of the confidentiality of the report. This is for security purposes and is important for the company.[2]
- Month and year the business plan was prepared
- Name of the preparer(s)

6. Executive Summary

This section of the business plan provides a brief, clear summary of what is contained in the business plan in print form. It states the goals and strategies of the business, emphasizes the uniqueness of the product or service and convinces lenders or investors to read the entire business plan. Serious investors receive dozens of business plans every week, and they have more business plans and related material to read than he or she can possibly digest. Therefore, this summary is used by the investor to determine if the business plan is worth reading in total. If the company writes an executive summary that "hooks" the investor, then the job is half finished. It is considered important by investors since they do not have to read through the entire plan to determine the amount of investment needed. Thus, the summary would highlight in a concise and convincing manner the key points in the business plan, financing needed, market potential, and support as to why this support will be needed. Therefore, the summary should clearly address the reasons why someone should invest in the company.

The one to four page summary should be written after all the other sections of the business plan have been completed. The summary should include brief statements on:

- The business and its products or services
- The market potential

[2] One possible statement of confidentiality is as follows: "This report is confidential and is the property of the co-owners listed above. It is intended only for use by the persons to whom it is transmitted and any reproduction or divulgence of any of its contents without the prior consent of the company is prohibited."

- The product and technology the company expects to capitalize on
- The track record and depth of the management team
- Abbreviated financial performance and projections
- Amount, uses, and terms for financing sought and the timing and method of repaying the financing

If the purpose of the business plan is to raise equity capital, the summary should include the investor's estimated return on investment and the buyout plan (public offering, sale, or buyout) the company expects to use.

In what follows a more detailed description of the main blocks of a business plan is given. Some overlap in the contents of some of these blocks was unavoidable because their final context will depend on the structure of the business plans and the topics included in different blocks. In some cases, depending on the strategy selected for writing the business plan, overlapping between blocks could be a logical consequence of the need to facilitate the reading, i.e. understanding of the business plan.

The key here is to prove that management understands what the most critical highlights of its business plan are and can express them concisely. Executive summaries that are too detailed and lengthy will not fulfill their purpose. Those that are too short and omit important points will also not be effective, and may mislead investors. Executive summaries project management's true feelings and attitudes about the plan's significant messages

7. The Business/The Company

The company should be described in detail in this section of the business plan including its history, current status, and future projections. The key elements of this section include:

- The company's operating history, present ownership, and future objectives
- The type of business (retail, manufacturing, service distribution)
- Description of the product(s) and/or service(s), including the product's function and uniqueness, patents, copyrights, or trademark status
- Outline of product(s) or service(s) in terms of their marketability
- Identification of business and the industry of which it is a part (This identification should be specific as to the products or services provided, the market segments targeted, and the competitive environment.)
- The company's role within the industry and the trends in that industry
- Primary goal(s) of the business
- Reasons for going into business
- Past and anticipated changes in the form of organization
- Founders, principal investors, and managers
- Structure of organization
- Past achievements and current strengths
- Past problems and current weaknesses

- Factors critical to the company's success and the potential problems and risks.
- Development work that has been completed to this date
- Technology involved
- Methods of record keeping—What accounting system will be used? Who will perform the record keeping? Is there a plan to help the company use these records in analyzing the business?
- Insurance—What kinds of insurance will be needed? What will these cost and who will be the carrier?
- Security—Address security in terms of inventory control and theft of information
- Is the building leased or owned? (state terms)
- Location—Describe site and why it was chosen. (If location is important to the marketing plan, focus on this in the marketing section of the business plan.)

Because much of this data is historical and factual in nature, this section tends to use much information from past business plans. Since it covers a broad range of company information, this section tends to be best completed by the general manager rather than functional specialists

8. Product or Service

In this section a full description of the product(s) or service(s) the company offers should be included, with an analysis of its competitive advantages and disadvantages.

- Description of product(s) or service(s) including what are unique features and why they are unique
- Brand names
- Production and sales mix for product(s) or service(s)
- Cost of sales and profit by product or service
- Customers and end users for product(s) or service(s)
- Patents and proprietary features
- Strategic opportunities and plans for expanding or redesigning product or service lines (If product development is an important part of the business strategy, then a sub-section should be prepared: see below.)
- Projected changes in sales mix, cost of sales and profit by product or service and reasons for changes

In some cases, it would be necessary to prepare a sub-section on product development. In broad, fairly nontechnical terms, the status of product development should be presented to allow someone reasonably familiar with the technology or industry to conclude whether the business is dealing with a concept, prototype, or product ready for market. Points to cover in this sub-section include:

- The extent of invention or development required to complete projects successfully
- The track record of key competitors in developing similar products

- The proprietary aspects of the technology to be used
- The reasons why the selected product is more advanced or better than the existing technology, products, or services

It may not be practical to include details on every single product or service. The important need is to adequately address enough of them to account for the dominant share of business activity, for example, to explain at least 80% of revenues. The less dominant product lines can be given relatively less mention according to their strategic importance to the business.

One key consideration in this section is the life cycle stage of each product group, and its relative contribution margin. Based on this data, decisions are made to phase out product lines, invest in new product ideas, and to initiate efforts to reduce the costs of products through redesign or investment in improved process technology.

9. Industry Analysis

It is important to assess the industry or industries in which the business functions. In particular, the business plan will be assessed by the potential investor on a number of criteria, one of which is the industry in which the company is or will be competing. For example, a high-growth market may be viewed more favorably by the potential investor. Discussion of the industry outlook, including future trends and historical achievements, should be included. The business plan should also provide insight on new products that have been developed in this industry. Competitive analysis is also an important part of this section. Each major competitor should be identified, with appropriate strengths and weaknesses described, particularly as to how they might affect the potential success of the new venture. Detailed information should also be provided about the key suppliers and customers.

The market should be segmented and the target market identified. Most new businesses are likely to compete effectively in only one or a few of the market segments. This strategy may be a function of the competition, who may be more vulnerable in one or a few segments of the total market.

Information should be provided for:

- Size, maturity, and competitive nature of the industry
- Barriers to entry, exit, and growth
- Role of innovation and technological change
- Government regulation
- Economic trends
- Total industry sales over the past several years
- Anticipated growth in this industry
- Number of new firms that have entered this industry in the past several years
- New products that have been recently introduced in this industry
- Nearest competitors
- Trends of the major competitors' sales

- Strengths and weaknesses of each of the competitors
- Financial position of the major competitors
- Profile of each of the customers
- Customer profile and its difference from that of the competition

In market economies, information on historical data, trends, segments, strengths and weaknesses of competitors, suppliers, customers, and applicable government regulations may be found in trade publications, security analysts' reports, business periodicals, and industry analyses prepared by specialized firms.

Data provided in this section is more open to independent verification than the data that pertains solely to the enterprise. It is therefore important that management demonstrate in this section its insight and complete understanding of the industry in which they operate.

This is also one of the areas where management often tends to lose objectivity, something to which investors are highly sensitive and vigilant.

10. Market Analysis and Strategy

This section of the business plan should be scrutinized carefully. Market analysis[3] should therefore be as specific as possible, focusing on believable, reasonable, and obtainable projections.

This section should demonstrate the firm's opportunities for achieving its goals in its targeted markets. The ability to market a product successfully is just as important as a product's development. In presenting a marketing strategy, therefore, a discussion should be included which covers:

- Definition of target market
- Segments of the target market
- Size and growth of the target market
- Trends in the target market
- Competitors: name, size, market share, competitive advantages, competitive disadvantages, business trends. Indirect and direct competition should be evaluated. It should be shown how the company can compete. Competition should be evaluated in terms of location, market, and business history.
- Identification of customers, their product/service references and reasons for purchasing
- Analysis of sales and profits by market segment and customers
- Company's current and projected market share
- Service and warranty policies
- Pricing and credit policies

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[3] Market potential is where financiers separate the inventors from the entrepreneurs. Many good products are never successfully commercialized because their inventors do not stop to analyze the market potential or assemble the management team necessary to capitalize on the opportunity.

- Advertising and promotion strategies
- Costs of marketing the product(s) or service(s)
- Location–The choice of location is related to target market; it should also be covered in this section of the business plan.
- The specific marketing techniques which will be used–that is, how to identify, contact and sell to potential customers
- Pricing–Pricing should be determined as a result of market research and costing of product or service. The pricing structure should be backed up with relevant supporting materials demonstrating the value added to the customer versus the price paid.
- Product Design–Key questions regarding product design and packaging should be answered, including graphics and proprietary rights information.
- Timing of Market Entry–The plan to enter the market should be presented.
- Methods of Distribution–The manner in which the products and services will be made available to the customer. This should be backed up with statistical reports, rate sheets, etc.
- Planned sales force and selling strategies (i.e. commissions, distribution of responsibilities) for various accounts, areas and markets
- Customer–how many there are and where they are located
- Customer service–which markets will be covered by the direct sales force, which by distributors, representatives, or resellers
- Specific approaches for capitalizing on each channel and how they compare with other practices within the industry
- Advertising and promotional plan–How advertising will be tailored to target market. Rate sheets, promotional material, and time lines for theadvertising campaign should be included.

The marketing plan is an important part of the business plan since it describes how the product(s) or service(s) will be distributed, priced, and promoted. Specific forecasts for product(s) or service(s) should be indicated in order to project profitability of the company, i.e. specific products and/or services.

Potential investors regard the marketing plan as critical to the success of the new venture. Thus, enough time should be taken to ensure that the strategy outlined can be effectively implemented. Marketing planning will be an annual requirement (with careful monitoring and changes made on a weekly or monthly basis) for the company and should be regarded as the road map for short-term decision making.

One of the initial important elements of information needed to prepare a sound business plan is the market potential for the product or service. The size of the potential market as well as the market trends and segments can be gleaned from industry resources and demographic surveys. Current sales and market data may be used to assess market share, buyer preferences, pricing, and service policies. The information obtained in this market feasibility study will support the company's marketing decisions in the business plan.

If resources allow, independent studies should be used to verify the potential of various markets or market niches. These studies, in addition to being highly credible, can be very helpful in demonstrating both to the company and to the financier the size and scope of the opportunity.

It is of utmost importance that the rationale presented in this section be in full agreement with the details of the previous section, Industry Analysis. The choice of marketing strategy is very heavily influenced on the industry environment. and the strategy must be customized to address the opportunities presented by industry conditions. As with the previous section, management's assessments of the marketplace are also subject to scrutiny from outside investors, who have industry and market data available from other sources for independent verification.

Another key consideration is the selection of target markets and determination of appropriate strategies to maximize marketing performance.

11. Operations/Production Plan/Manufacturing

The relevance of a feasibility study of the manufacturing and operations depends on the nature of the business. Current and proposed procedures and assets needed to produce the firm's product(s) or service(s) are described here. If the company is a manufacturing one, a production plan is necessary. This plan should describe the complete manufacturing process. Plans for operations should be outlined within various time frames; for instance, development, early manufacture, market development, and first product installation. Furthermore, a description of facilities, work force by job category, sources of supply and warranty, and service strategy should also be included. If some or all of the manufacturing process is to be subcontracted, the subcontractor(s) should be described, including location, reasons for selection, costs, and any contracts that have been completed. This section should also contain a description of the physical plant layout, the machinery and equipment needed to perform the manufacturing operations, raw materials and suppliers' names, addresses and terms, costs of manufacturing, and any future capital equipment needs. In a manufacturing operation, the discussion of these items will be important to any potential investor in assessing financial needs.

If the business plan is not prepared for a manufacturing operation but a retail store or service, this section would be titled as a "merchandising plan" and the purchasing of merchandise, inventory control system, and storage needs should be described. Some of the key elements for this section of the business plan include:

- Manufacturing process--Basic machine and assembly operations to be identified, as well as whether any of these operations would be subcontracted. If some manufacturing is subcontracted, who will be the subcontractor(s)? (Names and address should be given.) Why were these subcontractors selected? What are the costs of the subcontracted manufacturing? (Include copies of any written contracts.)
- Current and projected production levels and costs
- Production and quality control procedures

- Inventory and purchasing policies and needs
- Raw materials--The raw materials needed and costs should be determined.
- Major suppliers of specific materials: name, location, product, terms, advantages, disadvantages, anticipated changes
- Space--The total amount of space needed should be determined, including whether the space will be owned, leased, and so on.
- Plant--location, uses, value, financing, layout, area, advantages, disadvantages, anticipated changes
- Equipment--list of equipment needed immediately for manufacturing, future capital equipment needs, and whether it will be purchased or leased
- Labor--Each unique skill needed, the number of personnel in each skill, pay rate, and an assessment of where and how these skills will be obtained, including current personnel, projected needs, job categories, turnover, labor market, compensation, union affiliation, training programs and needs
- If a retail operation or service: From whom will merchandise be purchased? How will the inventory control system operate? What are storage needs of the company and how will they be promoted?

Each item may require some research and deeper information gathering, but is deemed necessary by those who will assess the business plan and consider funding the proposal.

It is impossible to overestimate the value of this section both to an outside investor and to the internal organization. Indeed, information in this section is vital to understanding the ability of the enterprise to sustain a profitable existence.

Outside investors are interested in the strategic elements of the production plan, such as current and projected capacity utilization, infrastructure conditions, industrial labor relations, strategic alliances, and technological capabilities. The significance to investors is in estimating the amount of new capital that will be needed to support long-term growth and ensure flexibility of the enterprise to enter new profitable markets and leave old unprofitable markets.

Internally, however, the production plan has an even more important role in supporting the management of operating and financial systems. It is the data in the production plan that determines the capacity requirements for the enterprise, both in terms of equipment and labor availability, and in terms of working capital. The logic is briefly summarized below.

A production plan is based on marketing's forecast of sales volumes for an anticipated product mix. There are different standard labor and material costs for each product. Different inventory policies may exist for each product group, thus affecting the production quantities to be processed and the timing of the production orders. Depending on the above projections of volume requirements and corresponding share of labor and equipment utilization content, the production plan will be used to generate detailed manufacturing schedules, employment plans, and organizational budgets.

Using the product mix and revenue projections in the production plan, and considering the corresponding standard costs, it is possible to project operating income and cash flows. This enables the enterprise to predict if and when special financial controls will be required, as well as if and when to elicit outside support, such as bank credit.

Changing inventory policies and adopting different manufacturing systems will affect the enterprise's operating efficiency and cash management capabilities. Increasing organizational productivity will reduce the standard costs of each product, and lead to greater profit potential. It will also enable the organization to provide wage adjustments to its employees, which may help to maintain steady supply of qualified labor.

There are other derivative benefits of investing as much time as necessary to develop this section as completely as possible, using valid data. For example, both the outside analysts and the business planning team will be able to review the physical layout of the facilities and suggest more efficient configurations. Or, key decisions may be prompted by the review of customer service policies that will have significant impact on other strategic considerations in other sections. For example, a decision to offer more custom, made-to-order products and less standard, made-to-stock products will reduce expenses related to the management of inventories. It will also necessitate more investment in process technology to provide the flexibility and speed of production necessary to compete in this manner. However, it will also have a great impact on the marketing strategy, since the enterprise will now be able to offer a new competitive strength to its customers, which may open up more sales opportunities.

Finally, and perhaps most importantly, this section must also contain two absolutely critical elements of the entire business plan:

1) what improvements are planned and how will they be achieved, and

2) an explanation of the metrics, that is, of performance measurements, that will be used to evaluate results.

Improvement strategies must be described in terms of relative priority, resource investment requirements, impact on organization, and timing of effects. Metrics must take into account the strategic mission, vision and preferences of the investors/owners of the enterprise, which are described in the initial sections of the business plan, and be in concert with the strategic marketing plans and financial projections disclosed in their respective sections.

12. Research and Development

If the product(s) or service(s) offered require further development or if the business regularly conducts research and development activities, these details should be included in this section.

- Current status of the development process
- Work required to complete the development process with information on personnel and equipment needed, cost and funding, and any problems anticipated.
- Ongoing and projected new research and development: purpose, assets, needs, costs and funding, expected benefits

It is important that this section clearly indicate the relative importance of R&D to the company in terms of its contribution to enterprise competitiveness and core competence. The projects described should indicate their relative priorities and expected payback. Efforts to invent new technologies and product groups should be mentioned separately from efforts to redesign existing versions of products or improve existing technologies.

Often new product designs also require new production process capabilities. These considerations should be described separately.

Special mention should be made of any other investment requirements of the R&D organization, for example, to strengthen its technical abilities by acquiring computerized tools. Any other planned initiatives that require capital budgeting or have significant strategic impact on the enterprise should be explained in this section. In particular, any potential impediments or risks to project success should be identified and their possible impact, along with corrective actions, discussed as thoroughly as possible. It is important to know the implications of project failure or success ahead of time

13. Management and Organization

The company's structure of organization and key management personnel are described in this section. First, the business' form of ownership, that is, proprietorship, partnership, or corporation should be described. If the business is a corporation, it is important to detail the shares of stock authorized, share options, names, and addresses and résumés of the directors and officers of the company. It is also helpful to provide an organization chart which indicates the line of authority and the responsibilities of the members of the organization.

Financiers invest in people–people who have run or are likely to run successful operations. So potential investors will look closely at members of the management team. The work force analysis should represent a head count by function or department (or both) for a specified time period. The team should have experience and talents in the most important management disciplines, such as research and development, marketing and sales, manufacturing and finance. This section of the business plan should, therefore, introduce the members of the management team, highlighting their track records. Detailed résumés should be included in an appendix. Descriptions should be given of who is behind the business. For each owner, information about their responsibilities and abilities should be given. For the personnel, descriptions of who will be doing the work, why they are qualified, their wages, and what their responsibilities are should also be given. This analysis not only will allow the management to better plan hiring, but also will demonstrate to potential investors the sensitivity of the business plans to the hiring of key personnel.

This section should be organized along these lines:

- Current structure of organization and anticipated changes
- The form of ownership of the organization
- If a partnership, who are the partners and what are the terms of the partnership
- If incorporated, who are the principal shareholders and how much stock do they own
- The type and how many shares of voting or nonvoting stock have been issued
- Decision making process and philosophy
- Key manager and owners: education, skills and experience: duties and responsibilities; compensation
- The members of the board of directors: names, addresses, and résumés
- Who has check-signing authority and control
- The background of each member of the management team (personal data such as education, age, special abilities, and interests)
- The roles and responsibilities of each member of the management team
- The salaries, bonuses, or other forms of payment for each member of the management team

The critical aspects of this section are to illustrate the congruity of organizational structure with business objectives. For example, it is necessary to align organizational responsibilities with corresponding areas of accountability, so that resources are provided to areas that need them the most. Conflicting priorities and incentives among functional units must be avoided as much as possible. The enterprise should acknowledge the existence of different product and market niche areas by organizing appropriately into strategic business units with as much autonomy and decentralized decision-making authority as is practical.

14. Assessment of Risk

Every business activity is faced with some potential hazards, given the particular industry, competitive environment, and the overall political and economic situation in the country. The business plan should also consider difficulties the company may encounter in the next two to five years. It is important for the manager to recognize the potential risks and prepare an effective strategy to deal with them.

In this section, the critical risks of the business and potential problems which may delay or prevent implementation of the company's proposed strategies should be discussed. Major risks for a business could result from a competitor's reaction; weaknesses in the marketing, production, or management team; and new advances in technology which might render the new product obsolete. Even if there is no risk from any of these factors, they should be discussed in the business plan and reasons provided as to why they are not a risk.

For each risk discussed, the company's plans to minimize the impact of the risk should be outlined. For each potential problem identified, the company's strategy to overcome the problem should be discussed. These contingency plans and strategies illustrate to the potential investor that the manager is sensitive to important risks and is prepared should any occur.

Although the purpose of this section is obvious, it merits pointing out that the ability to understand the business risks and develop contingency plans is critical for judging the quality of management. This section is an important indicator of the management's readiness to react effectively to situations that jeopardize the achievement of enterprise goals.

Though there are circumstances from time to time that cannot be anticipated, a business plan that is later found to have omitted consideration of specific variables that should have been known will raise doubts about the management's competence.

15. Financial Plans (Financial Statements and Projections)

The financial plan, like the marketing, production, and organization plan, is an important part of the business plan. It determines the potential investment commitment needed for the business and indicates whether the business plan is economically feasible. This information should address the extent of investment needed and provides the basis for a financier to decide on the potential future value of the investment made. Therefore, before preparing the business plan, the manager must have a complete evaluation of the profitability of the venture. The assessment will primarily tell the potential investors if the business will be profitable , how much money will be needed to launch the business and meet short-term financial needs, and how this money will be obtained (i.e. stock, debt, etc.).

There are traditionally three areas of financial information that will be needed to ascertain the feasibility of a business activity: (1) expected sales and expense figures for at least the first three years, (2) cash flow figures for the first three years, and (3) current balance sheet figures and pro forma balance sheets for the next three years. The financial statements and projections are the summaries, in monetary terms, of the organization's past history and future plans. As such, both sets of financial statements must be consistent with the narrative descriptions of the business, its plans, and the assumptions on which those plans are based. The financial statements should be accompanied by supporting documentation and explanations.

First the management should summarize the forecasted sales and the appropriate expenses for a least the first three - five years, with the first year's projections provided monthly. It includes the forecasted sales, cost of goods sold, and the general and administrative expenses. Net profit after taxes can then be projected by estimating

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[4] Detailed financial forecasts should appear in an appendix.

income taxes. Determination of the expected sales and expense figures for each of the first 12 months and each subsequent year is based on the market information discussed earlier. Each expense item should be identified and given on a monthly basis for the year.

The second major area of financial information needed is cash flow figures for three - five years, with the first year's projections provided monthly. Estimates of cash flow consider the ability of the business to meet expenses at proper times of the year. The cash flow forecast should identify the beginning cash, expected accounts receivable and other receipts, and all disbursements on a monthly basis for the entire year. Since bills have to be paid at different times of the year, it is important to determine the demands on cash on a monthly basis, especially in the first year. As sales may be irregular and receipts from customers may also be spread out, thus necessitating the borrowing of short-term capital to meet fixed expenses such as salaries and utilities.

The last financial item needed in this section of the business plan is the projected balance sheet. This shows the financial condition of the business at a specific time. It summarizes the assets of a business, its liabilities (what is owed), the investment of the owners and any partners, and retained earnings (or cumulative losses). Any assumptions considered for the balance sheet or any other item in the financial plan should be listed for the benefit of the potential investor.

This section should include the financial statements and projections:

- Business financial history[5]
- Statement of Income for the past five years[6]
- Balance Sheets for the past five years[7]
- Statement of Changes in Financial Position for the past five years
- Pro Forma Statements of Income, monthly or quarterly, for the next three to five years
- Pro Forma Cash Flow Statements, monthly or quarterly, for the next three to five years
- Pro Forma Balance Sheets for the next three to five years
- Break-even analysis[8]
- Past and projected key financial ratios, with comparisons to appropriate industry ratios

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[5] Business financial history is a summary of financial information about the company from its start to the present. The business financial history and loan application are usually the same.
[6] The income (profit and loss) statement shows the business financial activity over a period of time (monthly, annually). It is a moving picture showing what has happened in the company and is an excellent tool for assessing the company. The ledger is closed and balanced and the revenue and expense totals transferred to this statement.
[7] The balance sheet shows the condition of the company as of a fixed date. It is a picture of the firm's financial condition at a particular moment and shows whether the financial position is strong or weak. It is usually done at the close of an accounting period, and contains assets, liabilities, and net worth.
[8] Break-even analysis helps identify when a company's expenses exactly match the sales or service volume. It can be expressed in total dollars (i.e. local currency) or revenue exactly offset by total expenses or total units of production (cost of which exactly equals the income derived by their sales). This analysis can be done either mathematically or graphically.

- Documentation for figures used in pro formas
- Assumptions on which pro formas are based
- Accounting principles employed
- Explanation of any extraordinary items in statements
- Auditors' opinions

15.1 Financing Sought and Repayment Plans

In this section, the description of any financing the firm is seeking with the submission of this business plan, i.e. the Financing Sought and Repayment Plans, should also be included:

- Total amount of funds needed[9]
- Financing sought from the lending institution or investors who will receive the business plan: amount, terms, security
- Repayment schedule for debt financing
- Estimated return on investment (and method of buying out the venture capital for equity financing if appropriate)
- Sources for other funds needed
- Uses projected for funds sought
- Current capitalization structure

15.2 Sensitivity Analysis

Based on the examination of potential problems and risk for the business, sensitivity analyses on the pro forma financial statements should be performed by varying the key assumptions. Presentation of three sets of pro formas may be useful: best case, most likely case, and worst case. The implications of the results of each sensitivity analysis performed should be described. By varying the assumptions on which the projections and strategies were based the consequences of favorable and adverse future events on the business should be assessed.

16. Appendix/Supporting Documents

The appendix of the business plan generally contains any backup material that is not necessary in the text of the document. Only the supporting documents that will be of immediate interest to the potential lender should be included. The others should be available on short notice. Reference to any of the documents in the appendix should be made in the plan itself.

Letters from customers, distributors, or subcontractors are examples of information that should be included in the appendix. Any documentation of information, that is,

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[9] Summary of financial needs is an outline indicating why the firm is applying for a loan and how much is needed.

secondary data or primary research data used to support plan decisions, should also be included. Leases, contracts, or any other type of agreements that have been initiated may also be included in the appendix. Lastly, price lists from suppliers and competitors may be added.

As an appendix, appropriate documents from the following list should be included:

- Market analysis data
- Product specifications, photographs
- Advertising copy samples
- Organization chart
- Résumés of owners and managers[10]
- Personal financial statements of owners[11]
- Tax records for the company and the principle owners
- Leases[12]
- Contracts[13]
- Letters of commitment from major customers, suppliers, lending institutions
- Letters of reference[14]
- Credit reports[15]
- Legal documents[16]
- Miscellaneous documents[17]

17. Using and Implementing the Business Plan

Based on the analysis, goals set, and business plan prepared, the next step is to develop a detailed schedule to implement each of the strategies planned. Successful implementation of a business plan doesn't happen just because a roomful of people exchange a lot of ideas about how to implement it. A disciplined step-by-step approach to the implementing process is critical to the effort. The implementation plan should include a listing of all the activities necessary to accomplish each goal. Marketing, production, management, personnel, and financing strategies and tasks must be coordinated with one another. Effective implementation of the business plan can be enhanced by developing a schedule to measure progress and to institute contingency plans. A timeline, on either a monthly or quarterly basis, should be included with projected completion dates for each planned activity. It is important that the

[10] Personal resumes - Should be limited to one page and include work history, educational background, professional affiliations, honors, and special skills.
[11] Personal financial statement-A statement of personal assets and liabilities. For a new business owner, this will be part of the financial section.
[12] Copies of leases-All agreements currently in force between the company and a leasing agency.
[13] Contracts-Include all business contracts, both completed and currently in force.
[14] Letters of reference-Letters recommending the managers as being a reputable and reliable businesspersons, worthy of being considered a good risk. (Include both business and personal references.)
[15] Credit reports-Business and personal from suppliers or wholesalers, credit bureaus, and banks.
[16] Legal documents-All legal papers pertaining to the company legal structure, proprietary rights insurance, titles, etc..
[17] Miscellaneous documents-All other documents that have been referred to, but are not included in the main body of the plan (e.g., location plans, demographics, advertising plan, etc.)

implementation of strategy contain control points to ascertain progress and to initiate contingency plans if necessary. Controls necessary in manufacturing, marketing, financing, and the organization should be carefully selected. On a frequent basis (i.e. beginning of each month) the profit and loss statement, cash flow projections, and information on inventory,[18] production,[19] quality,[20] sales,[21] collection of accounts receivable, and disbursements[22] for the previous month should be checked. This feedback system should be simple but be able to provide key members of the company with current information in time to correct any major deviations form the goals and objectives outlined.

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[18] Inventory control-By controlling inventory, the firm can ensure maximum service to the customer. The faster the firm gets back its investment in raw materials and finished goods, the faster that capital can be reinvested to meet additional customer needs.

[19] Production control-Compare the cost figures estimated in the business plan against day-to-day operation costs. This will help to control machine time, labor person-hours, process time, delay time, and downtime cost.

[20] Quality control-This will depend on the type of production system but is designed to make sure that the product performs satisfactorily.

[21] Sales control-Information on units, dollars/local currency, specific products sold, price of sales, meeting of delivery dates, and credit terms are all useful to get a good perspective of the sales. In addition, an effective collection system for accounts receivable should be set up to avoid aging of accounts and bad debts.

[22] Disbursements-The management should also control the amount of money paid out. All bills should be reviewed to determine how much is being disbursed and for what purpose.

Appendix 1

Outline of a Business Plan • Example I

I. Cover Sheet

Serves as the title page of your business plan. It should contain the following:

- Name of the company
- Company address
- Company phone number (include area code)
- Logo (if you have one)
- Names, titles, addresses, phone numbers (include area codes) of owners
- Month and year your plan was issued
- Name of preparer

II. Statement of Purpose

(Same as executive summary.) This is the thesis statement and includes business plan objectives. Use the key words (who, what, where, when, why, how, and how much) to briefly tell about the following:

- What your company is (also who, what, where and when).
- What your objectives are.
- If you need a loan, why you need it.
- How much you will need.
- Why you will be successful.
- How and when you plan to repay your loan.

III. Table of Contents

A page listing the major topics and references.

IV. The Business

Covers the details of your business. Include information about your industry in general, and your business in particular. Address the following:

- Legal structure
- Description of the business
- Products or services
- Location
- Management
- Personnel
- Method of record keeping
- Insurance
- Security

V. Marketing

Covers the details of your marketing plan. Include information about the total market with emphasis on your target market. Identify your customers and tell about the means to make your product or service available to them.

- Target market

- Competition
- Method of distribution
- Advertising
- Pricing
- Product design
- Timing of market entry
- Location
- Industry trends

VI. Financial Documents

These are the records used to show past, current and projected finances. The following are the major documents you will want to include in your business plan. The work is easier if these are done in the order presented.

- Summary of financial needs
- Sources and uses of funds statement
- Cash flow statement (budget)
- Three-year income projection
- Break-even analysis

VII. Supporting Documents

These are the records that back up the statements and decisions made in the three main parts of your business plan. Those most commonly included are as follows:

- Personal resources
- Personal financial statement
- Credit reports
- Copies of leases
- Letters of reference
- Contracts
- Legal documents
- Miscellaneous documents

Appendix 2

Outline of a Business Plan • Example II

I. **Introduction and Summary of Business Plan**
- Purpose of the plan
- Business and history of the company
- Major customers
- Summary of comparative income statement results
- Address and telephone number

II. **The Company: Its Industry and Objectives**
- Industry background
- Corporate short- and long-term objectives
- Company size; market share
- Expected rate of profitability goals
- Strategies to reach objectives

III. **Products and Services**
- Principal products or services
- Proprietary position and potential
- Product development
- Trademarks and royalty agreements

IV. **Market**
- Assess market size, history, market segments, and product position in the market
- Costs/benefits of the product
- Market pricing: company's strategy
- Evaluation of competition: type of competition, customer service, lead time, price, terms, location, product quality
- Marketing strategy defined: how and why will sales be made
- Describe type and size of customer base; relationship and percent of total sales with major customers; stability; special terms
- Product distribution and sales force
- Advertising and promotion approach
- Product or product-line profitability and markups

V. **Manufacturing**
- Plant locations and description of facilities
- Describe manufacturing process if unique
- Capital equipment requirements
- Labor force
- Cost and quality control
- Back-up sources of supply

VI. R&D and Engineering

- Status of product line; what remains to be done, how, time required, at what cost
- Product life cycle, technical obsolescence
- Plans to meet competition and/or obsolescence
- Needs for manufacturing and applications engineering
- Proprietary and patent position

VII. Management

- Management team, responsibilities, skills
- Identify principal owner-managers
- Human resource projections and plans
- Supporting external advisors and relationships: attorneys, accountants, investors, and lenders
- Board of directors

VIII. Historical Financial Data

- Latest balance sheet plus income statements for past two to three years
- Provide brief explanation of operating variances
- Consider sales and cost of sales data by product line if significant

IX. Financial Plan and Forecast

- Profit and loss/cash flow forecast, by month or quarter for first year, and by year for years two and three
- Forecasted balance sheets at year ends
- Provide summary of all significant assumptions used in forecasts considering sales plan, changes in customer base, selling price increases, margin improvements, material and labor and other operating cost increases, capital expenditures required, changes in receivable collection patterns, inventory lead time and turnover, trade credit terms and availability, and the effects of income taxes

X. Proposed Financing

- Desired financing
- Use of proceeds
- Securities or debt instruments offered, terms
- Payback and collateral

XI. The Future

- Commentary and summary on where the company is going

V. OPERATING THE BUSINESS

A. Implementing and using the business plans. ii

B. Financial analysis (see this section of the financial management handout)

C. Use of Funds.

1. **Working capital.**

There is a tendency when profits are good to make too heavy an investment from working capital in long term assets (land, building, equipment) for purposes of expansion. You use up your operating funds (working capital), when the expansion will require more operating funds (inventory, accounts receivable). Should finance long term assets with long term financing.

To illustrate we shall first look at an example where both current assets and current liabilities are used to purchase fixed assets such as land, building, and/or equipment for the purpose of expanding sales (turnover). More current assets (cash, inventory, accounts receivable) are needed to handle the increased sales. Current liabilities are being increased to make payments on the fixed assets and to provide short term finances for purchasing inventory, etc.

These actions cause working capital (difference between current assets and current liabilities) to decrease when it should be increasing. Even though fixed liabilities are being paid off and net worth increased, the business cannot pay its current obligations such as salaries and pay for purchases of merchandise.

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ii Reference is made to this topic in Djordjija Petkoski and Steven R. Dimitriyev, 1994. Back ground note : How to write a business plan, Economic Development Institute, World Bank.

RATIO ANALYSIS

Using the data contain in the income statements (table 15.1) and balance sheets (table 15.3), make the following ratio analysis for year 4.

CURRENT RATIO = ... =

ACID - TEST RATIO = ... =

SOLVENCY = NET WORTH / TOTAL ASSETS = ... =

NET PROFIT = ... =

GROSS PROFIT = ... =

SALARY COST = ... =

PROFIT ON EQUITY * = ... =

* Assume the value of manager labor to be $ 20,000.

INCOME BY DEPARTMENTS, YEAR 5

	DEPT A	DEPT B	DEPT C	TOTAL
	$	$	$	$
SALES	140,000	80,000	75,232	295,232
COST OF GOODS	70,000	35,000	46,218	151,218
GROSS PROFIT	70,000	45,000	29,014	144,014
EXPENSES :				
DEPRECIATION	3,000	2,000	3,178	8,178
TAXES	9,000	4,000	5,344	18,344
SALARIES	25,000	15,000	12,197	52,197
VEHICLES	2,000	1,000	2,078	5,078
ADVERTISEMENT	2,800	1,200	1,698	5,698
UTILITIES	3,000	1,500	2,910	7,410
SUPPLIES	2,500	1,000	2,582	6,082
BUYING EXPENSES	1,000	200	188	1,388
INSURANCE	1,000	600	526	2,126
OTHER EXPENSES	800	300	1,085	2,185
TOTAL EXPENSES	50,100	26,800	31,786	108,676
PROFIT	19,900	18,200	-2,772	35,338

INCOME STATEMENTS

ITEM	1990	1993
SALES	$188,537	$249,884
COST OF GOODS	83,415	105,907
GROSS PROFIT	105,122	143,977
EXPENSES		
DEPRECIATION	4,328	6,910
TAXES	10,218	15,527
SALARIES	34,669	54,164
VEHICLES	3,317	4,319
ADVERTISING	2,574	4,825
UTILITIES	3,135	6,265
SUPPLIES	2,633	5,154
BUYING EXPENSES	1,307	1,175
INSURANCE	1,300	2,420
MISCELLANEOUS	2,095	1,837
TOTAL EXPENSES	65,576	102,596
NET PROFIT	39,546	41,381
AVG. VALUE OF ASSETS (BOOK VALUE)	118,859	170,662
AVG. MARKET VALUE OF ASSETS	170,000	265,000
VALUE OF OWNERS' TIME	20,000	26,000
RETURN ON INVESTMENT (ASSETS)	19,546	15,381
% ROI (BOOK VALUE)	16.4	9.0
% ROI (MARKET VALUE)	11.5	5.8

A better strategy is illustrated by the second example. In this situation the fixed assets are financed with a long term loan (fixed liabilities). The business burrows an additional Rs. 10,000 each year and because of expanded business is able to pay off Rs. 10,000 each year (the business was paying Rs. 5,000 each year before the expansion).

Note that in the second case, working capital increased each year to handle the expanded volume of business. Realistically, perhaps there should have been some increase in current liabilities.

Expanding the business using current assets and current liabilities to purchase fixed assets and the effect of this action on working capital.

ITEM	YEAR				
	1	2	3	4	5
			(000 RS.)		
CURRENT ASSETS	50	45	40	35	30
FIXED ASSETS	100	110	120	130	140
TOTAL ASSETS	150	155	160	165	170
CURRENT LIABILITIES	10	15	20	25	30
FIXED LIABILITIES	50	45	40	35	30
NET WORTH	90	95	100	105	110
TOTAL LIA. + N.W	150	155	160	165	170
WORKING CAPITAL (a)	40	30	20	10	0

(a) Difference between current assets and current liabilities.

Expanding the business using long term financing (increasing fixed liabilities) to increase current and fixed assets and the affect of this action on working capital. (a)

ITEM	YEAR				
	1	2	3	4	5
			(000 RS.)		
CURRENT ASSETS	50	55	60	65	70
FIXED ASSETS	100	105	110	115	120
TOTAL ASSETS	150	160	170	180	190
CURRENT LIABILITIES	10	10	10	10	10
FIXED LIABILITIES	50	50	50	50	50
NET WORTH	90	100	101	120	130
TOTAL LIA.+N.W.	150	160	170	180	190
WORKING CAPITAL (b)	40	45	50	55	60

(a) The business in borrowing an additional Rs. 10,000 each year and is paying off Rs.10,000 annually.

(b) Difference between current assets and current liabilities.

Liabilities are being paid off and net worth increased, the business cannot pay its current obligations such as salaries and pay for purchases of merchandise.

A better strategy is illustrated by the second example. In this situation the fixed assets are financed with a long term loan (fixed liabilities). The business borrows an additional R.10,000 each year and because of expanded business is able to pay off R.10,000 each year (the business was paying R.5,000 each year before the expansion).

Note that in the second case, working capital increased each year to handle the expanded volume of business. Realistically, perhaps there should have been some increase in current liabilities which would slow down the annual increase in working capital.

2 **Concept of Financial Leverage.**

The term sounds as if this may be a complicated topic. It can be but from a practical way of looking at the subject, the concept is relatively simple.

It relates to whether the business will find it to the benefit of the business to borrow money. Remember when doing the ratio analysis, we started that the best measure of the performance of a business was the percentage return on our Net Worth : $\dfrac{\text{Profit (returns to net worth)}}{\text{Net Worth}}$

Suppose that profit after paying the owner - manager as a percentage of new worth is 20% we can borrow funds for 15% to expand. Since earnings are greater than the interest rate, the borrowed funds will cause our percentage returns to go even higher even though we must now pay interest. This would be considered a favorable leverage situation.

However, suppose we have just the opposite situation. The cost of borrowed funds is 15% when we are earning only 10% on our Net Worth. In this cause we have an unfavorable leverage situation because the interest we would pay for the loan would decrease our profit causing the returns to fall to less than 10 %.

Hence, in a favorable situation borrowed funds enhance or increase earning while in an unfavorable situation borrowed funds cause a decrease in profits or earning.

'able 12. Effect upon return on investment of alternative equity position for selected arden centers after three years of operation.[a]

	Garden Center A Percent equity			Garden Center B Percent equity		
em	100	50	25	100	50	25
come ($)	93,984	36,312	7,476	42,342	21,405	10,889
quity ($)	961,205	480,602	240,301	349,474	174,737	87,368
OI (%)	9.8	7.6	3.1	12.1	12.2	12.5

Equity based on original investment depreciated for three years. Income for the 50% and 25% equity positions reduced by 12% interest on the debt.

SOURCE: BARTON, S.S.; HAYDU, J.J.; HINSON, R.A.; MCNIEL, R.E.; PHILLIPS, T.D.; POWELL, R.D.; AND STEGELIN, F.E. 199 ESTABLISHING & OPERATING A GARDEN CENTER: REQUIREMENTS AND COSTS, GARDEN CENTERS OF AMERICA, WASHINGTON, D.C.

D. Breakeven Analysis

Often times businesses and/or lenders are interested in knowing at what level of sales in Rs. or number of physical units the business will break even. By this we mean that all accounting costs are covered or the business makes zero profit. The handout on Breakeven analysis gives numerous examples and uses of the technique. Breakeven techniques represent a good means of performing some of the sensitivity analysis referred to in the business plan.

BREAKEVEN ANALYSIS

Sales forecasting represents an educated estimate of how much of a particular product will be sold during the next time period. Managers should have some idea what the effect of variations in sales volume will be upon the business.

Therefore, a breakeven analysis is often made to ascertain at what volume of sales the business will just breakeven--that is, sales receipts will just offset costs. Thus, the breakeven volume of sales represents the minimum acceptable volume of business. Also, the same type of analysis can be used to ascertain the volume of business which must be generated to give a predetermined level of profit or the effect of changing costs of inputs or product prices.

We have been looking at several examples of application of breakeven analysis. However, in spite of its value, we should not get too carried away with what the analysis shows us. Several inherent weaknesses limit its use.

Perhaps the more serious problem with breakeven analysis is the assumption of linearity. Generally both the price of the product and variable costs are not independent of the level of sales. In the short-run more product can be sold only if price is reduced. More can be produced and/or sold only if variable costs are increased such as by paying overtime wages. Thus, over some range we can expect both the total revenue and total cost curves to become nonlinear curves instead of straight lines.

Also, we have indicated that costs can be classified as variable and fixed. Actually, many costs are fixed over short ranges but vary between them. In other words, as volume increases, more items considered as fixed are required. Some items of cost just don't fit one classification or the other but are partially both. We often think of utilities as being variable but some minimum amount of the phone, electricity, and heating bill is required regardless of volume.

Although I applied the technique to a multi-product store, the particular application is best applied to a single product. In multi-product situation normally there are wide variations in the cost of goods for different lines of merchandise as well as differences in the other variable costs for each item.

Breakeven analysis based on a given set of data should be viewed as short run in nature. Too many things change even within a year to consider the analysis as "the answer."

Breakeven analysis is only as good as the data used and as the manager who interpretes the answers. It should be used in conjunction with the cash operating budgets discussed earlier.

AUTOMOBILE

Total Costs	Total Per Year	
	10,000 mi.	20,000 mi.
Fixed	----------dollars--------	
Depreciation	2,500	2,500
License	250	250
Insurance	600	600
Total fixed	3,350	3,350
Variable:		
Gasoline	750	1,500
Tires	100	20
Maintenance	200	400
Total variable	1,050	2,100
TOTAL COSTS:	4,400	5,450
Unit Costs	Costs Per Mile	
Fixed	.335	.168
Variable	.105	.105
Total per mile	.440	.273

Suppose you are reimbursed at the rate of $.25 per mile. What is your breakeven number of miles?

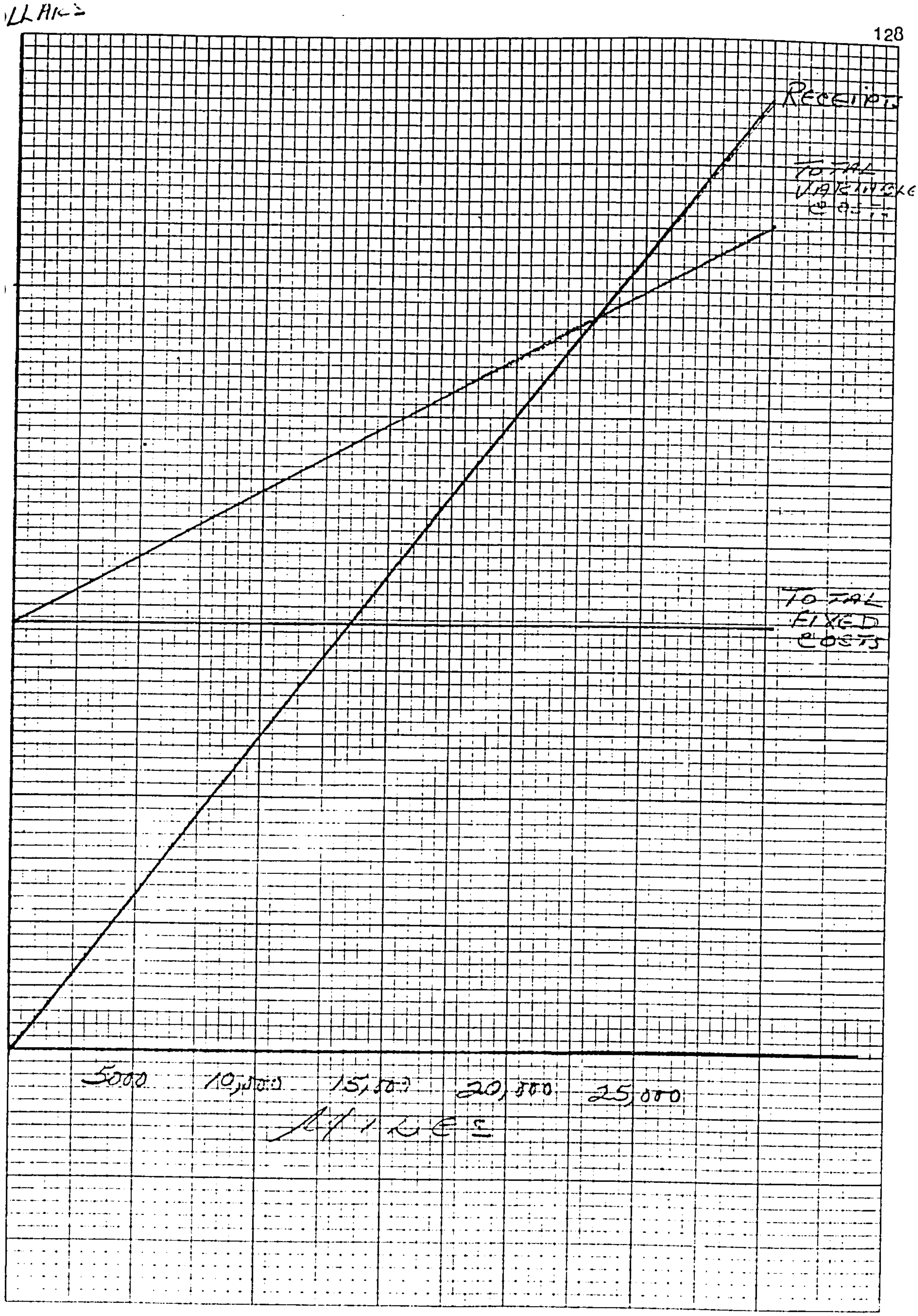
$ .250 -- reimbursement
.105 -- variable margin
$ .145 -- contribution margin

$$\frac{\text{Fixed costs}}{\text{Contribution margin}} = \text{breakeven margin} \qquad \frac{\$3,350}{.145} = 23,104 \text{ miles}$$

Revenue - 23,104 X .25 = $5,776

Costs:

Fixed	$3,350	
Variable 23,104 @ $.105	2,426	
Total Costs		$5,776
Net Profit		- 0 -


LLARS
RECEIPTS
TOTAL VATEIABLE COSTS
TOTAL FIXED COSTS
5000
10,000
15,000
20,000
25,000
MILES

FEED MILL

A 6-ton per hour capacity feed mill has an annual fixed cost of $62,500. Assume the feed being produced by the mill is selling for $190 per ton. Variable costs per ton are as follows:

$ 6	variable cost of operating mill
169	ingredient cost (cost of goods)
$175	total variable costs

a. What is the breakeven level of production?

$$\frac{\text{Total fixed cost}}{\text{Selling price - total variable cost (contribution margin)}}$$

$$\frac{\$62{,}500}{\$15} = 4{,}167 \text{ tons}$$

b. What level of production would give a $125,000 profit?

$$\frac{\text{TFC + profit}}{\text{Contribution margin}}$$

$$\frac{\$62{,}500 + \$125{,}000}{\$15} = 12{,}500 \text{ tons}$$

c. If ingredient costs go up to $174, what is the breakeven level of production?

$$\frac{\$62{,}500}{\$10} = 6{,}250 \text{ tons}$$

d. If wage rates go up $2 per hour (a ton requires 0.5 hours of labor), what is the breakeven level of production?

$ 7	variable cost of mill
169	ingredient cost
$176	

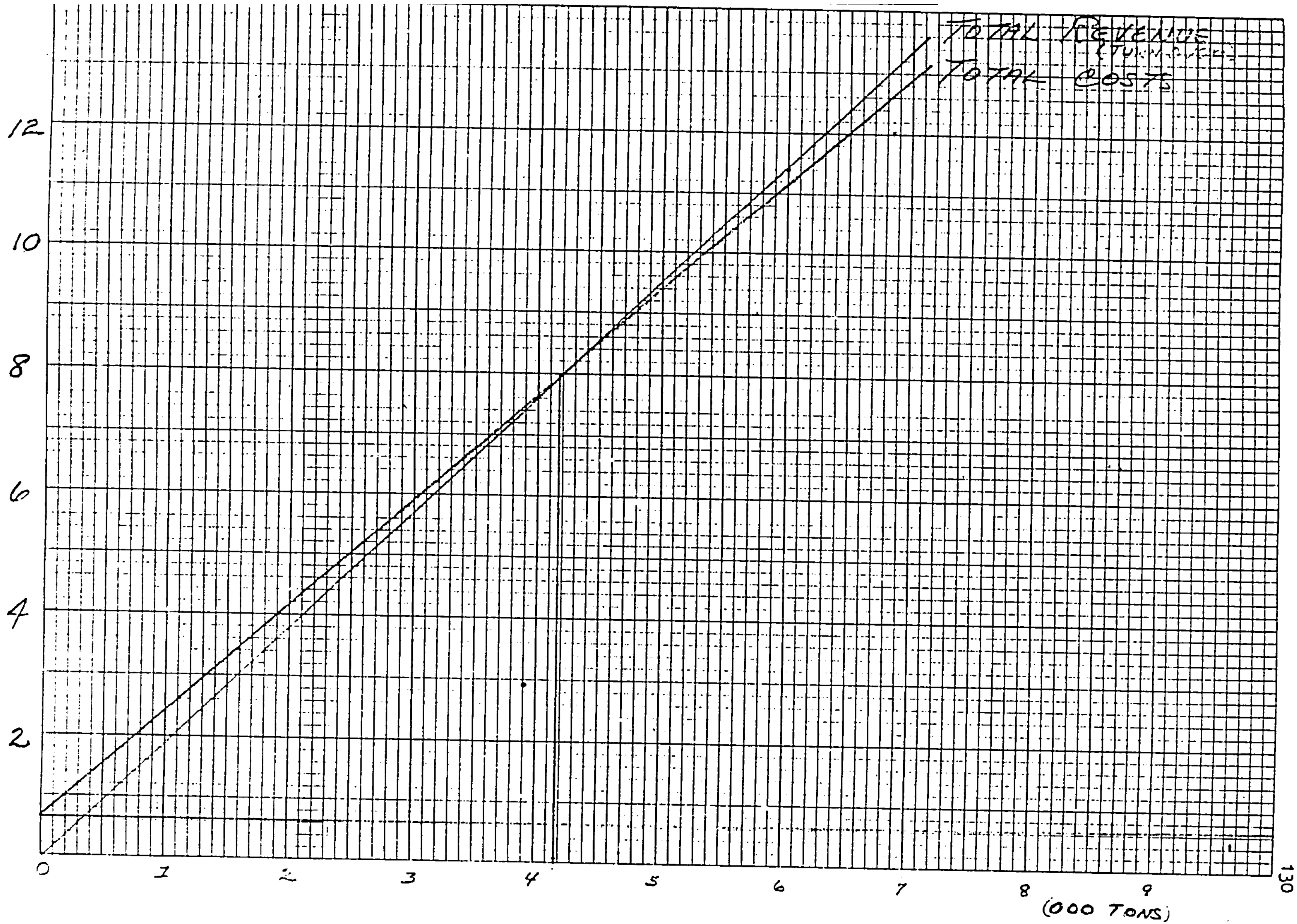
$$\frac{\$62{,}500}{\$14} = 4{,}464 \text{ tons}$$

e. Suppose price for feed is reduced to $185 per ton. What is breakeven level of production?

$$\frac{\$62{,}500}{\$10} = 6{,}250 \text{ tons}$$

Price fell from $190 to $185 or 2.6%

Volume must increase from 4,167 to 6,250 tons or 50% in order to breakeven. An increase in volume of this magnitude will be difficult to achieve.



TOTAL REVENUE
TOTAL COST
12
10
8
6
4
2
0
1
2
3
4
5
6
7
8
9
130
(000 TONS)

MULTI-PRODUCT RETAIL STORE

Store does $500,000 in business. In checking past records find that cost of goods averages 60%. Net profits have been about 10% and of expenses approximately 50% each have been fixed and variable.

Dollars	Item	Percentage
500,000	Sales	100
300,000	Cost of goods	60
200,000	Gross profits	40
50,000	Net profits	10
150,000	Expenses	30
75,000	Fixed cost	15
75,000	Variable costs	15

Contribution Margin:

$500,000	Receipts
-300,000 - 75,000	Variable cost
$125,000	Contribution margin

Contribution Rate:

$$\frac{\$125{,}000 \text{ Contribution margin}}{500{,}000 \text{ Receipts}} = 25\%$$

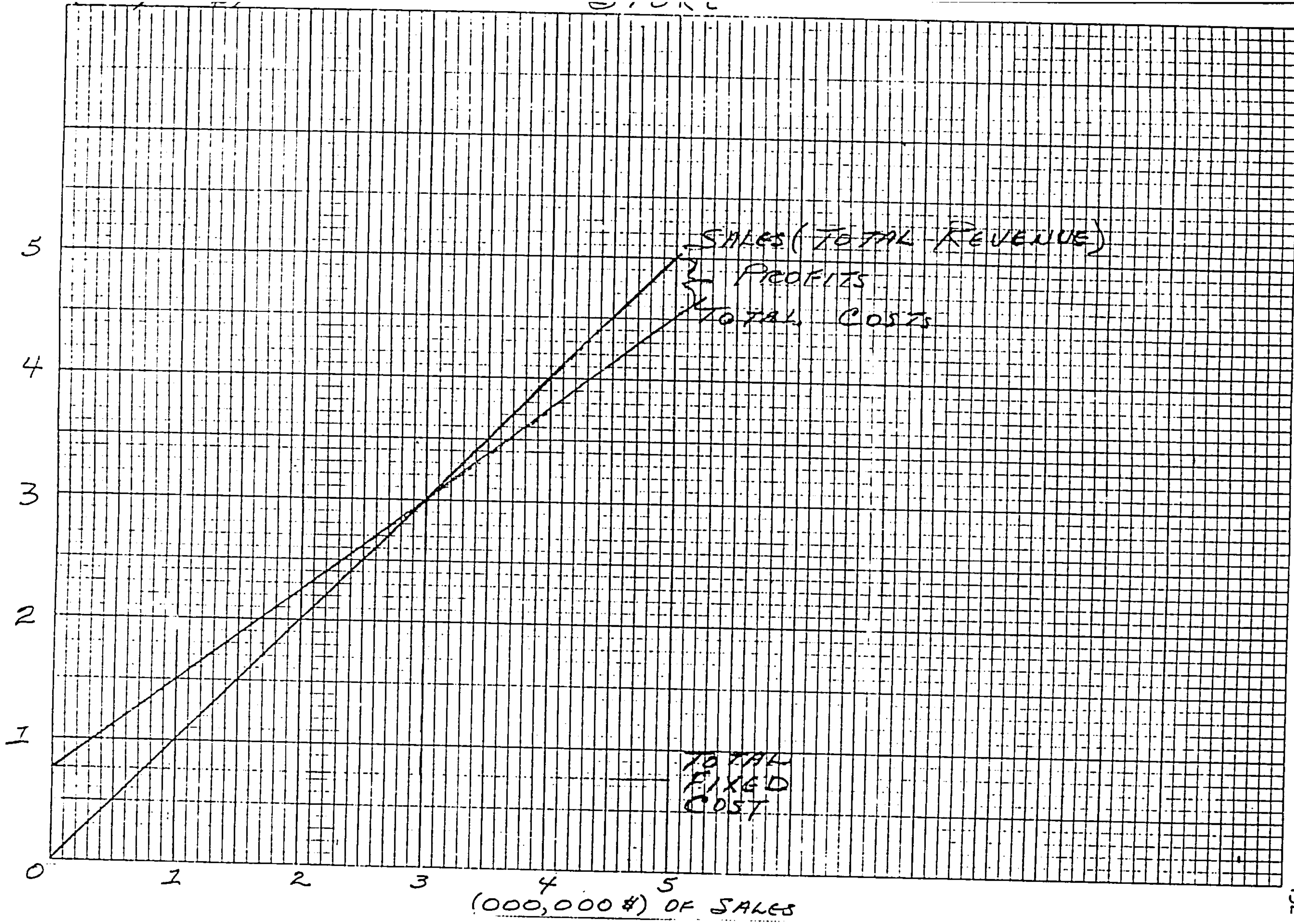
Breakeven volume of Sales:

$$\frac{\$75{,}000}{.25} = \$300{,}000$$

Volume (TR)	$ 0	$300,000	$500,000
Costs:			
Total variable	0	225,000	375,000
Total Fixed	75,000	75,000	75,000
Total Cost	75,000	300,000	450,000
Profit	(75,000)	-0-	50,000

Volume of business which will leave you with a $40,000 after income tax profit if you must pay 50% of your income in state and federal income taxes?

$$\frac{\$75{,}000 + \$80{,}000}{.25} = \$620{,}000$$


SALES (TOTAL REVENUE)
PROFITS
TOTAL COSTS
TOTAL FIXED COST
0
1
2
3
4
5
(000,000 $) OF SALES

VI OTHER TOPICS

Many additional other topics might be identified for consideration if time permitted. However, we shall limit our time to (1) use of cooperatives,(2) use of trade association, and (3) some discussion of vertical coordination in agribusiness. Of course cooperatives represent a formal means of vertical coordination while trade organizations or associations may represent an informal form of vertical coordination.

A. COOPERATIVES

Over time and in different parts of the world, cooperatives have been structured differently. From a management point of view and for our purpose, we shall refer to cooperatives as an extension of businesses who pursue the profit motive. The reason for being associated with a cooperative is to enhance or improve profits from the primary business. Examples of types of cooperatives then would be those organized to jointly purchase inputs, those organized to coordinate the orderly marketing of products, and those organized to jointly provide services to their members. Some examples of the latter may be finances, insurance, information, medical services etc.

The purpose may be summarized as to :

1. provide for purchase of a dependable supply of inputs at a competitive level of prices.
2. Provide for a dependable market with competitive prices.
3. provide services for membership at reasonable prices.

Working together cooperatively can give small agribusiness some of the advantages enjoyed by larger businesses.

Since members of cooperatives are mostly involved in operating their individual businesses, management and operation of cooperatives often suffer. Let us examine some of these primary problems.

1. Management
   a. Difficult to select a good Board of Directors.
   b. Key to success is selecting good managers who gets good support from Board.
2. Method of adjusting price to cost so that member enjoy benefits of cooperatives.
3. Source of investment and operating funds.
4. Operating within the laws and regulations with regard to unfair business practices.

B. TRADE ASSOCIATIONS

Through out the world there are many trade organizations or associations. A good trade association has many of the same features as a good service cooperative. As a matter of fact, trade associations are often organized the same way as cooperatives.

Let us begin by looking at some of the advantages of forming a trade association.

1. Bring business managers engaged in common actives together to address common problems.
   a. Legislation
   b. Educational information and seminars.
   c. Form cooperatives.

2. Bring business managers at different levels of the market channel together to work out problems and to bring about better vertical coordination.
   a. Better understanding of each other's problems
   b. Legislation
   c. Work out improvements in business practices - better communication, grades and standards, resolving problems, etc.

Need to have a good board of Directors.Very important to have a good executive officer who sees that the wishes of the membership are carried out.

Often local trade association is a member of a regional or national association.

Requirements for success

1. Obtaining and keeping membership up.
2. Insuring that have strong participation at meetings.
3. Maintaining good lines of communication between the board, executive officer, and the membership.

C. VERTICAL COORDINATION

For many years, the business world talked about vertical integration when business investeo in activities both before and after their main activity. This action is of course to have control of additional levels of their marketing channel.

Today, however, a some what less involved investment arrangement is often discussed under the title of vertical coordination. A vegetable processor may in the past have purchased land to produce vegetable to insure that the plant would have the vegetable planted at a time to keep the plant running. Also the plant needs to control the quality of the vegetables coming to it. Other than problems of weather, owning production allowed he plant to operate efficiently turning out a consistent processed product. Beyond the processing plant, the business may want to control storage and transportation.

Today many arrangements are made to accomplish the equivalent of ownership as far a coordination of the flow of the product through the marketing system. The vegetable production mentioned earlier may be contracted. However, to give the processor control, the processor has field people to coordinate planting time, cultural practices, harvesting time and the quality of the product. The processor may provide the seed in order to control this variable. Joint ventures are often used to better coordinate activities.