

# Chapter 11

# Financial planning and forecasting

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## Learning outcomes

- Discuss the purpose of a financial plan detail
- Define 'financial plan' and financial policy'
- Discuss the purpose of a financial policy in detail
- Name and discuss the different components of a financial policy and their influences

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## Learning outcomes (cont.)

- Determine a break-even point
- Name and discuss the various types of finance
- Discuss the importance of cash flow in a small business venture
- Define 'forecasting process' and discuss this concept
- Develop the three financial statements used in the forecasting process

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## Planning

Planning: thinking what and how a required outcome, result or objective should be obtained. Planning involves:

- Identification and formulation of objectives
- Gathering all necessary data
- Analysing the data
- Drawing up the plan
- Implementation of the plan

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## Financial policy

Policy: sets out guidelines or principles according to which an enterprise must act in obtaining its objectives. Components of financial policy:

- Forecasting and planning
- Major investment and financing decisions
- Coordination and control:
  1. Setting standards
  2. Compare actual results with standards
  3. Evaluation of deviations
  4. Take corrective action when necessary
- Risk management

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## Financial plan

- Is concerned with:
  - Investigating the choice between two or more alternatives
  - For reaching a specific objective
  - Determining how each specific goal is to be achieved
- Involves the effective acquisition, use and control of financial resources

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## Purpose of financial plan

- Provides specific outcomes of future activities in monetary terms
- Provides the necessary figures to back the various choices made

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## Purpose of financial plan (cont.)

- Factors to consider when developing a financial plan:
  - The industry and competition
  - The market
  - Current economic and political circumstances
  - Technology
  - Social environment
  - Ecological environment



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## Break-even point

$$\text{Quantity} = \frac{\text{Fixed costs per unit}}{(\text{Price} - \text{Variable costs})}$$

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## Limitations of break-even point analysis

- Not easy to classify all costs as either fixed or variable
- Elements of fixed and variable costs are not always constant
- Excludes qualitative factors
- Instability of monetary value not taken into account

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## Financial forecasting

- Financial-planning process steps:
  - Project financial statements
  - Determine funds to support five-year plan
  - Forecast funds available for next five years
  - Establish and maintain system of controls
  - Develop procedures for adjusting basic plans

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## Reasons for forecasting

- Forecasting enhances quality of planning
- Control function is made easier
- Enhances integration and coordination of various opinions and needs
- Actual performance of various departments and personnel can be measured more easily

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## The forecasting process

- Information needed:
  - Operating budget
  - Projected cash budget
  - Projected statement of profit or loss and other comprehensive income
  - Projected statement of financial positions

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## Pro-forma financial statements

### The pro-forma statement of cash flows

- A statement of an entity's planned cash inflows (money physically coming into the business)
- Cash outflows (money physically going out of the business)
- It is used to estimate an entity's short-term cash requirements.

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## The pro-forma statement of profit or loss and other comprehensive income

- A statement used to plan whether an entity will be making a profit or a loss
- During a given financial year
- Taking into account all the income that is to be received
- All the expenses that has to be paid

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## The pro-forma statement of profit or loss and other comprehensive income (cont.)

- To prepare:
  - Compile sales or fee-received projection
  - Compile operating schedule
  - Determine any other expenses
  - Calculate projected profit



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## The pro forma statement of financial position

- A planned financial statement on a certain date to determine the financial position of the entity with respect to its capital generated and the application thereof