Constructing Your Financial Plan

The most unfamiliar segments of your business project will likely be the Financial Plan and Dividend Distribution. Deconstructing your proposed business into its many moving parts and financial responsibilities may seem intimidating, but categorizing each of your costs into one of three categories will make the process clear and straightforward. Follow the steps below to better determine the financial aspects of your business.

Categorize your Costs

Every dollar that a business spends is considered to be one of three types of cost: Fixed, Variable, or Startup. Your first task is to identify all of the ways in which your business would have to spend money, and determine which type of cost that expense would be.

- **Fixed Costs**
    - A fixed cost is an expense that your business faces on a schedule, which does not depend on the number of customers/sales that your business makes. It's best to convert these into equivalent monthly costs so they can be summed together. Consider: does your business...
        - Have a website or other digital subscription?
        - Pay wages on a schedule?
        - Pay for rent, utilities, storage, or other brick-and-mortar requirements?
        - Have any scheduled debts or dues to other organizations?
        - Require insurance on a vehicle or other large investment?
        - Perform scheduled maintenance, cleaning, or updates?
        - Advertise regularly?
- **Variable Costs**
    - A variable cost is an expense that is a function of the number of customers/sales that your business makes. In other words, it is a cost you have to pay proportional to the number of clients you serve. It is best to convert these into equivalent "per customer" costs so they can be summed together (for example, if 100 paper coffee cups cost $4.00, then you face a variable cost of $0.04 for a paper cup each time you sell a coffee). Consider: does your business…

    - Create a physical product for each customer?
    - Pay any fees to outside organizations on each sale?
    - Pay wages dependent on number or sales?
    - Consume/destroy materials or other goods for each customer?

- **Startup Costs**

    - Startup costs are exactly what you would expect. Any costs that your business will face one time and one time only, before you ever receive a single customer, qualify as startup. This will determine how much you ask your potential investors to contribute to the business. Consider, does your business:

        - Require an inventory of pre-made products?
        - Face any one-time purchases? (Vehicles, furniture, machinery, etc.)
        - Require initial labor? (Design, construction, etc)
        - Have enough emergency funds to remain open during its first months?

The Break-even Analysis

At this point you should have three important numbers: **Total Fixed Costs** (per month), **Total Variable Costs** (per customer), and **Total Startup Costs**.

Now, you get to choose your **Marginal Revenue**, which is the price at which you plan to sell your product. Using these four numbers, calculate:

- **Gross Profit** = Marginal Revenue - Total Variable Costs

    - This is how much money you profit with each sale.

- **Gross Profit Margin** = Gross Profit ÷ Marginal Revenue

    - This is the percent of each dollar of sales that your business will keep as profit.

- **Required Sales** = Total Fixed Costs ÷ Gross Profit Margin

    - This is the number of customers you need each month to pay your fixed costs, or "break even."

Constructing Your Dividend Distribution

The judges in the Business Fair have been asked to select the business that represents the most realistic, reliable, and attractive return on capital for the investor. In order to make this decision, potential investors would want to know how much startup capital is required, how the business plans to use its profits, and what incentives the investors would receive.

Startup Capital

- You have likely determined this amount already, in your financial plan. Investors will want to know how much money you require, and how it will be spent.

Profit Distribution

- If your business ever meets more than its minimum number of required sales to break even, you will find yourself with some profits. Investors will want to know how that money will be spent, and in what proportions. Consider: will your business…
    - Expand and grow
    - Pay bonuses to employees
    - Invest in markets
    - Donate to charity
    - Provide dividends

Incentives

- What will your investors get in return for funding your business? What will entice them to invest in the success of your ideas? Among other incentives, you may choose to offer:
    - Dividends: The most common investment arrangement. Dividends represent a percent of all profits made, as outlined in the profit distribution.
    - Scheduled payment: A contract for a set of regular payments over a predetermined number of years. This incentive can be included as a fixed cost in your financial plan.
    - A cut of the sales: For every sale that you make, a certain percentage of the revenue may go to your investors. This incentive can be included as a variable cost in your financial plan.

Playing with the Numbers

You should keep a few things in mind while organizing your financial plan:

- You do not need to provide a reference for every single cost in your business, as long as those costs are reasonable. However, you should be able to provide a reference for any unusual or particularly large costs.

- Keeping these organized in a spreadsheet will save you a lot of time. You will likely want to adjust your costs and marginal revenue several times, and a live spreadsheet will make the process much easier.

- Don't fret over the minutia. Yes, your business probably requires staples at some point, but these are relatively negligible unless your business is an office supply store. If you want to be safe, you can create a provisionary or buffer budget as a fixed cost, to cover the minor payments that are too small to list.