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MODULE 5 FINANCE

How do we know if our business is viable?

To do this we will have to check if our **income or collections forecast is going to be higher than the expenses**.Don't be scared because we are only going to deal with very simple financial concepts (we won't go much further than addition and subtraction), thanks to which we will see if my business idea is economically profitable. For this we are going to use a **treasury** or cash flow forecast sheet.

Furthermore, we are going to see how a project can be made viable. This means what measures we can take to make the business profitable- Generally when projects are born they are not profitable and we must learn to make them economically viable.

Key concepts:

- **Sales income** (collections from clients).

  In a previous step of the business plan, you already defined the income structure of your business, what is the different types of income that your company expects to obtain through the sale of your products and/or services. Well now it's your turn to predict how much you think you will earn each month over the course of a year with your business.

  To calculate the expected income for a given month, follow these steps:

1. **Estimate the sales volume or number of transactions.** In a previous point of this Business Plan you already estimated For each source of income, the sales volume or the number of transactions you expect to make in the month. How you saw you could use historical data, growth projections and any other relevant information to make these estimates.

2. **Estimate the average price.** In a previous point in this Business Plan you already calculated the sales price per transaction for each of your income sources. If you sell multiple products or services, you can use the average price for each category. If you have a price history, use it as a reference.
3. **Multiply the sales volume by the average price.** Multiply the estimated sales volume or number of transactions by the average price for each revenue source. This will give you an estimate of the expected income for each one.
4. **Add up all the income estimates (for the different income sources).** Add up all your income estimates to get your total expected income for the month. This will be your general income projection for the period in question.
5. **Consider external factors.** Take into account external factors that could affect your income. For example, special events, holidays, changes in the economy or market trends that could influence your sales. Adjust your estimates accordingly. Remember that estimates are approximate and may be subject to change. However, performing this exercise will provide you with a solid foundation to plan your operations and evaluate the performance of your business.

- **Variable costs for each month** .

  What are variable costs? Variable costs are those expenses that change proportionally with the level of activity or production of a business. That is, these costs fluctuate depending on the quantity of goods produced or services provided. The more you produce or sell, the greater the variable expense will be; and if production or sales decrease, variable expense will also reduce.

  Importance of estimating variable costs. Correctly predicting costs for each month in a business is essential for effective financial management, making informed decisions and improving profitability. It helps maintain economic stability and provides a competitive advantage by allowing the company to quickly adapt to changing market conditions.

What should our cost structure be like initially?

TIP: It is important to keep in mind that in the early stages of starting a business, we have to try by all means to ensure that our variable costs are proportionally much higher than our fixed ones. This will allow us to have more financial flexibility and reduce risks in the event that the business does not prosper.

To do this, it is important to carry out a good negotiation with our suppliers so that in these first beginnings, for example, the cost of our agency or our marketing services provider is based on our sales and not a fixed cost.

Examples of variable costs:

- **Raw materials and supplies:** Expenses on raw materials necessary to produce goods or services. These costs vary depending on the quantity of products manufactured or services provided.
- **Salary of employees linked to production:** If you need to hire people to help you, the salaries of employees who work directly in the manufacturing of goods or services. If production increases, more direct labour is likely to be required and therefore the associated variable cost will increase. **(keep in mind that in this cost you must include, in addition to the worker's salary, the social security costs associated with the salary - an average of 30% of the gross salary in Spain -)**
- **Packaging and Shipping:** The costs related to packaging and shipping products to customers. These expenses will increase with the number of products sold and shipped.
- **Energy and material consumption:** The costs of electricity, water, gas or other inputs that increase when more is produced.
- **Advertising and marketing:** These are expenses that vary directly depending on the level of activity or the scope of the advertising and marketing strategies implemented by a company.

- **Sales commissions** : If you need to hire people to help you with sales, the costs associated with commissions are paid to sellers based on sales made. As sales increase, so do commission costs.

- **Fixed costs for each month**

  What are fixed costs? Fixed costs are a type of business expense that do not vary in relation to the amount of production or sales of a company during a given period. These costs remain constant regardless of whether the company produces many products or none, or whether it sells many goods or services or none.

  Importance of estimating variable costs. It is important to note that although these fixed costs do not change with production or sales, they still must be taken into account to determine a company's break-even point and profitability. In the short term, fixed costs may be more difficult to adjust compared to variable costs, which change in relation to production or sales.

  Examples of fixed costs:

1. **Entrepreneur salaries and administrative staff:** The salaries and wages of full-time employees or administrative staff who are not directly linked to production or sales are fixed costs. **(keep in mind that in this cost you must include, in addition to the worker's salary, the social security costs associated with the salary - an average of 30% of the gross salary in Spain -)**
2. **Self-employed fee:** It is the monthly tax that self-employed workers must pay to be covered by the Social Security system and access different benefits and rights **(the minimum fee in Spain is around €370, although the first years usually have a flat rate of around €80).**
3. **Insurance:** Insurance premium costs (e.g., liability insurance, property insurance) generally remain constant over a given period.
4. **Rent:** The cost of leasing or purchasing a commercial or office facility is a fixed expense, which remains constant over the period of the lease.

5. **Professional services:** Includes fees for external professional services, such as accountants, lawyers or consultants.
6. **Services:** While some service costs may vary, minimum or fixed charges (such as Internet connection and telephone fees) are fixed costs.
7. **Information technology costs:** Includes the costs of software, hardware and services related to the information technology used in the company.

What salary should the entrepreneur have?

The entrepreneur cannot get the salary he wants. Its maximum or ceiling must be set by what is established by the country's labour legislation in the tables of each collective agreement.

The rest of the benefits can come out as dividends, although you have to take this into account.

It would be convenient to set ourselves the minimum living wage to survive and thus reduce the financing we need in the initial stages and we will increase it when there is money in the company.

And the salary that I should have received during these months I am accruing, that is, it remains in accounting as a debt that the company owes me. And when there starts to be money on hand, it is returned.

In short, it is about initially avoiding strangling the company.

- **What prior investments do you need to make? In how many instalments are you going to pay them?**

It is quite possible that to start working with your business you need to buy some machinery, design a website or make some type of prior investment of high economic value. It is also important to consider these costs in the viability and cash flow plan of the business.

IMPORTANT NOTE: The purchase of a property is an investment that should be avoided whenever possible at the beginning of a business to avoid risks and provide ourselves with greater flexibility. Renting whenever a space is required to develop the business is the best option for beginnings.

How do you know if your project is initially viable? When do you start to make a profit?

Knowing the viability of a project is essential before launching it to avoid wasting our time and money.
An analysis of our cash flow forecast for the first months will give us a lot of relevant information on the feasibility of our project over time.
Answer these questions and you will have an idea about the viability of your project:

1. **How long does it take to equal revenue to costs?**
   It is about analysing the initial balance of your project during the first months and seeing how long it takes you to reach the moment in which the income covers the costs (your sales are large enough to cover expenses), that is, the moment in which you no longer You have losses every month but you start making profits.
   If you reach this balance point in a reasonable time, then it is viable! .
   But if you take too long, your accumulated losses may already be so high that you will not be able to get enough money to finance yourself during this time or to pay it back in time.

2. **When do you start making profits?**

When the initial balance begins to be positive, that is, when we begin to make a profit and not losses, we will have left the Valley of Death! and we will begin to find ourselves in a more comfortable situation.

That is why we must try to make a profit (get out of the "valley of death") as quickly as possible, since it is a bad area of scarcity and precariousness for the business.

How much money do you need to start your project? That is, how much financing do you need?

Knowing the financing needed before starting a business is essential because money is the fuel that keeps all business operations and activities running. Understanding financial requirements from the outset allows for proper planning, ensures the business is prepared to meet financial challenges, and increases the chances of long-term success.

Lack of adequate financing can lead to the failure of a business, so it is important to approach this aspect seriously and carefully from the beginning.

How do you know how much money you will need to avoid problems of lack of cash when starting a business?

To know the total financing needs that we will need, we will look again at the change in trend in the initial balance of the treasury sheet, that is, when the accumulated losses no longer increase but begin to decrease because the income is greater than the expenses. At this moment, we will have the maximum treasury or liquidity tension, that is, the highest negative amount will tell you **the financing you need to create your company and not run out of money halfway!** Now you just have to figure out how to get that money…

Bootstrapping techniques to reduce the need for financing

At the moment in which we see that the company is viable because I see that I can achieve the sales I need and the "valley of death" has a certain duration, we are already clear about how much financing we need and in what month, that is when we have to apply Bootstrapping (that is, start thinking about how to set up the company with as little financing as possible, that is, with self-financing).

These are some techniques to avoid having to ask anyone for money (you are much happier and sleep better when you don't owe money). Furthermore, once we have alleviated the need for financing, we can focus more on the client, which in the end is what really matters.

- Delay payments. Finance things and pay at the end of the year.
- Advance customer collections (discount for prompt payment, discounted annual subscriptions...).
- Factoring (advance the annual collection by the bank).
- Discount lines.
- Campaign credit policies.

Sources of funding

And finally, if you have already made the most of Bootstrapping techniques, here are some financing ideas to get the money you need:

- Personal savings: Use your own savings to finance the start of the business. This will allow you to have full control over the property and you will not owe interest to third parties.
- Loans from family and friends: If you have close people willing to invest in your project, you could ask them for loans with clear agreements on repayment and interest.
- Bank loans: Banks offer various types of loans for entrepreneurs. Prepare a solid business plan and present a well-reasoned application.
- Government grants and aid: Find out if there are grant or aid programs available for entrepreneurs in your area or sector. These funds typically do not require repayment, but may have certain criteria and requirements to qualify.
- Crowdfunding: Crowdfunding platforms like Kickstarter or Indiegogo allow people from all over the world to contribute small amounts of money to fund your business in exchange for rewards or exclusive products.

- Leasing: If you need to purchase expensive equipment or machinery, leasing allows you to obtain it with monthly payments and at the end of the contract, you generally have the option to purchase it at a reduced price.
- Business Partners: Look for business partners or investors who share your vision and are willing to invest capital or resources to drive the business.

In summary...

- Throughout the development of a business it is advisable to create a cost structure appropriate to the moment in which I am. In this sense, the creativity, cunning of the entrepreneur and having a plan B is essential. You have to find a way to avoid having to make investments at the beginning, designing a loose structure to foresee that if things go badly for me at the beginning, I will be able to get out as quickly as possible.