Financial Plan and Product Development

Learning Outcomes

By the end of this unit the learner will be able to:

- ✓ Understand different types of business ownership and structures
- ✓ Evaluate franchising and business purchasing opportunities
- ✓ Create a pitch deck, executive summary, company presentation, technical white paper, and business plan

Financial Plan and Product Development

Gathering Funding

The Basics of Financial Statements
Many entrepreneurs find the financial aspects of their new business the most overwhelming part to deal with. It's often wise to have the help of a professional accountant. However, you also need to understand the basic reports that you will be working with. Here is a quick overview.

The Income Statement
The **income statement** can also be called a profit and loss statement or operating statement. This is a summary of the income and expenses of a business during a certain period: monthly, quarterly, or annually. If the company has more income than expenses for a certain period it has net income (a profit). If the expenses exceed income, the company has a net loss.

Income can be broken into two broad categories: **service income** and **sales income**. The difference between the two lies in the need to consider inventory costs. Service income is derived from performing a service while sales income is derived from selling a product. In general, service companies have staff that perform a service for a customer, while sales companies have product that they sell.

With service income, the profit can be determined simply by deducting expenses associated with performing the service. With sales income, however, you must consider the cost of creating the product (raw materials, labor, overhead, etc.). This inventory cost is referred to as the **cost of goods sold**.

Income Statement Equation
The income statement equation typically looks like this:

$$Revenue - Expenses = Net\ Income\ or\ Loss$$

- Revenue is what the business earned from the sale of goods and services during this period.
- Expenses are bills (phone and Internet bill, insurance, payroll, advertising, etc.) incurred during this period.
- Net income or loss is the net financial result of the business efforts during that period. It must be added to the Equity portion of the balance sheet, which we will discuss in a moment.

Some examples of the types of accounts that influence net income and are reported on the income statement include:
- Revenue
- Advertising expenses

- Repair expenses
- Utilities expenses
- Wage expenses

Sample Income Statement

Acme Widgets Inc. Income Statement For the Month Ended February 28, 20xx		
REVENUE		
Widget Sales		$20,000
Widget Installation		$1,500
Interest Income		$500
Total Revenue		**$22,000**
EXPENSES		
Rent	$4,500	
Utilities	$1,200	
Advertising	$8,000	
Wages	$5,000	
Total Expenses		**$18,700**
NET INCOME (LOSS)		**$3,300**

The Balance Sheet
The purpose of a balance sheet is to show what a company owns and owes as of a specific date. Income statements are prepared "for the period ending" and balance sheets are prepared "as at" a certain date.

The balance sheet summarizes what the business owns and compares it to what the business owes. It does so in a standard format to make it easy to see what kind of financial shape the business is in. If a business has more assets than liabilities, that's a good sign. On the other hand, if a company has more liabilities than assets, it might be a sign of trouble.

Balance Sheet Equation

$$Assets - Liabilities\ = Equity$$

- **Assets** are anything that the business owns. Some examples: cash, office equipment, vehicles, tools, real estate, buildings, and land. **Bills that are prepaid** (such as monthly insurance premiums) are also considered an asset, as are **accounts receivable** (money that others owe to you).
- **Liabilities** are anything the business owes to others, including banks and suppliers. Money which a company owes as a result of its ongoing trading are generally called **accounts payable**.
- **Equity** is often a measure of what the business is worth. It is the combination of profits and money invested in or withdrawn from the company by its owners.

This is what people refer to as balancing the books: ensuring that this equation is always in balance.

Accounts typically reported on the balance sheet include:

- Accounts receivable (money owed to the company but not collected)
- Cash
- Equipment
- Accounts and notes payable
- Prepaid items
- Unearned revenue
- Vehicles, land, and buildings, and their accumulated, individual depreciation (decrease in value)

The term **consolidated balance sheet** refers to the "consolidation," or adding together, of individual balance sheets of various related companies into one balance sheet which shows the financial position of the entire group of companies.

Current vs. Fixed Assets
On a balance sheet, the assets of a business are generally broken down into two groups: current assets and fixed assets.

Current assets are generally considered to be anything that will be converted into cash within one year, such as cash, accounts receivable, and inventory. Current assets continually turn over through the company.

Fixed assets are more permanent in nature. This includes vehicles, equipment, machinery, land, and buildings. They represent an investment in items that are necessary to carry on its normal operations. Fixed assets can also revolve (to purchase new equipment or update technology, for example) but usually they revolve very slowly.

Liquidity measures how quickly a company can convert its assets into cash. An ample cash balance provides security that the company can meet its obligations. The easier the conversion is, the more liquid the asset. Here is a list of current assets in order from most to least liquid:

- Accounts receivable
- Inventory
- Fixed assets

Cash Flow Statement
This shows the flow of cash for an accounting period. This statement is a bridge between the cash accounting method and the accrual accounting method in that it analyzes what transactions impacted cash and what were accruals.

The cash flow statement is usually divided into three sections.

Operating

- Cash flow for day-to-day operations
- Examples: Customer revenue, tax payments, interest, supplies purchased

Investing

- Cash flow generated from or consumed by assets
- Examples: Sale of a vehicle or purchase of a building

Financing

- Cash flow in from selling stocks or bonds or borrowing

- Cash flow out from purchasing stock back, paying out dividends, and repaying borrowed money

Statement of Retained Earnings
This statement shows how much of the company's profits were kept inside the company and not paid out in dividends.

Sample Statement of Retained Earnings

Statement of Retained Earnings for Acme Widgets Inc. As At February 28, 20xx	
Opening retained earnings	0
Add net income for the period	$3,300
Total Retained Earnings	**$3,300**
Minus dividends paid	(300)
Retained earnings	**$3,000**

Brainstorming Solutions
Brainstorm ways that you could obtain funding for your new business.

Funding Options

Friends and Family
You'll often hear this group referred to as the 3 F's: friends, family, and fools. Generally, this group is not a good source of funding for your business. Keep your personal and professional lives separate to ensure that your business gets off on the right foot.

Banks
Many entrepreneurs get a small business loan from their bank. Often, the bank will require some sort of security in case you are unable to repay the loan. Be sure to review loan terms very carefully.

Government Programs
Most governments offer resources to help new businesses. This can come in the form of payroll rebates, low-interest loans, or grants. Check with all levels of government to see how they can help you.

Private Programs
Large businesses and non-profit organizations may also offer resources to help entrepreneurs. Check with industry organizations, your mentor, and the Internet to see what is available in your area.

Venture Capitalists
Venture capitalists provide funding to startup companies (usually high-tech) in exchange for shares or equity. This usually means that they will profit if the startup company goes public or gets sold. Keep this in mind if you are seeking money from venture capitalists.

Angel Investors
Angel investors are typically wealthy individuals with money to invest in companies that appeal to them. They often enjoy the challenge of starting up a new business and may look for opportunities where they can be hands-on.

Bootstrapping
Bootstrapping means building a company from your own money and assets. Profits are then reinvested in the business. Typically, bootstrapping works best for very small companies with low startup costs,

short sales cycles, and simple products. This is the route that many part-time, home-based businesses use. Although it can decrease your debt and increase profits, if you don't generate enough revenue to invest back in the business it can also stunt the business' growth.

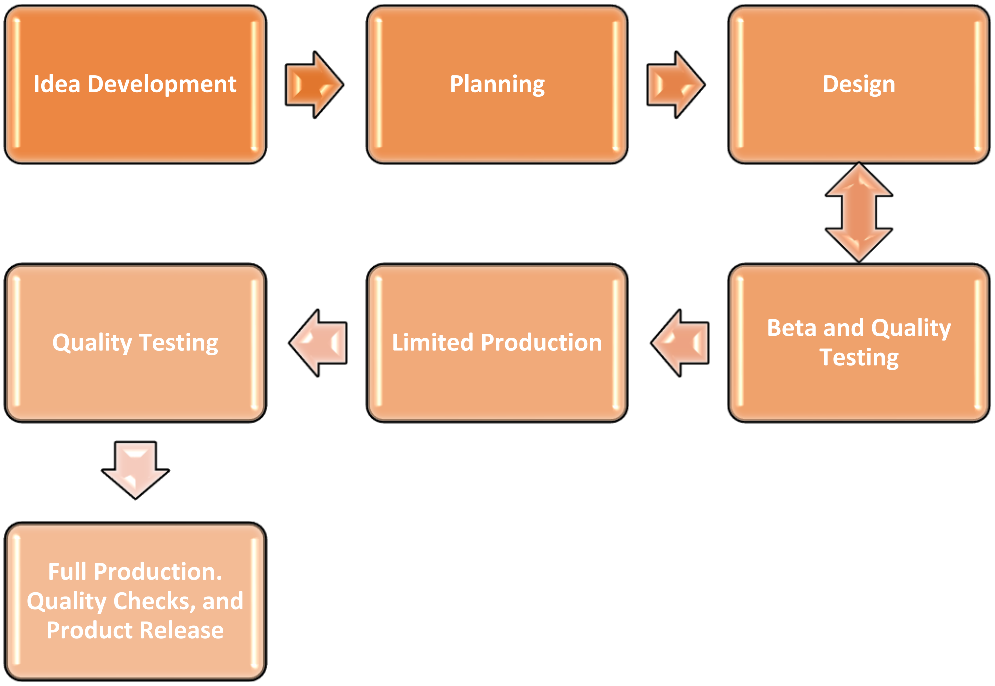
Crowdfunding, Sponsorship, and Co-Op Programs
Asking your customers to help you start your business is another way to generate revenue without going into debt. In exchange for their support, your business will provide them with a product, service, membership benefits, and/or co-op ownership rights.

Bartering
You can also consider bartering to help start your new business. For example, let's say you sell single-serve coffee machines and you need design help for your website. Perhaps you could find a local web design firm and offer them a machine and a service contract in exchange for their help. This also helps you get your product out in the marketplace and establish friendly relations in your community. Just be sure that you're getting back what you give.

Developing Your Product

The Steps of Product Development

Process Overview
There are many models for product development, but most models have the following phases:



Notice the dual arrow between steps three and four: the results of beta testing will often necessitate a return to the design phase to make minor adjustments and fix issues.

The model that you use will depend on the type of product that you are creating, but your processes should be documented before you begin product development. Let's take a closer look at each phase of the model.

Idea Development
This is where you describe:

- What the product is and what problem it solves
- What the general aim of the product is
- Who is buying the product and who is using the product

Planning
Next, it's time to plan out the details of the product by creating four requirement documents.

Market and Customer Requirements

- What problem exists in the market?

- What does the problem look like to customers?
- What do customers want in a solution?
- What do customers need in a solution?
- What are our competitors doing?

Functional and Non-Functional Requirements

- **Functional requirements** describe items that solve particular problems for users. (Example: Coffee machine sanitizes itself after each brewing cycle with water temperature of 212°F.)
- **Non-functional requirements** involve the background operation of the product or service. (Example: Coffee machine will weigh less than two pounds.)
- It can be helpful to prioritize requirements, particularly for early product designs.

Engineering Requirements

- Describe the technical specifications of the design.
- Define terms that will be used in the design of the product, particularly jargon or ambiguous terms.
- Describe what materials will be used in the product.
- Include patents and technologies that will be used or developed.

Testing Requirements

- Describe how testing will be performed and documented. Create use cases if appropriate.
- Outline performance targets. (Example: Coffee maker must start up within 15 seconds.)
- Allow for variation where appropriate. (Example: Coffee machine will weigh between 1.8 and 2.2 pounds.)
- Include any external inspections, approvals, etc. that will be required.
- Create procedures for re-testing, rejection, and production changes.

Design

Now it’s time to design the product. The output of this stage will be your product’s prototype. Be sure to set and enforce design timelines so that this stage does not drag on forever while the team tries to create the perfect product. Emphasize that this is a starting point. Encourage the team to add to the requirements documents as new issues are raised.

Beta and Quality Testing

Once the prototype is complete, it can be tested. Testing procedures will vary depending on the product, but can include:

- Checking the product against the requirements documents
- Use cases conducted in a lab
- Usability testing with real people (in focus groups or within the company, for example)
- Safety inspections

Once this round of testing is complete, the product either proceeds to limited production or (more often) goes back to the design phase for minor tweaks and adjustments.

Limited Production and Quality Testing
After the prototype has passed beta testing, it goes into limited production for a trial run of your production and quality testing procedures. If this trial run goes well, then you can proceed to the final stage.

Full Production, Quality Checks, and Product Release
At the final stage, your full production and quality assurance procedures are put into action. Minor revisions and adjustments will probably need to be made, but the general process should remain the same.

Protecting Your Intellectual Property
Intellectual property can be a very tricky subject, particularly in our digital age. It is always best to consult an expert to make sure that your business' assets are protected.

What is Intellectual Property?
The term intellectual property (IP for short) refers to any creative product (such as a product design, logo, screenplay, etc.) that can be copyrighted, trademarked, or patented. When a product is copyrighted, trademarked, or patented, the owner then has control over how their product is reproduced and used by others. The legal rules for copyright vary by jurisdiction, so do your research and know what applies to you. The World Intellectual Property Organization (http://www.wip.int) is a good international starting point.

Following the Rules
Before you establish your business name, domain name, product name, etc., ensure that it is not registered to anyone else or copyrighted. There are a variety of copyright organizations and Internet resources that can help with this. If you need help, contact a copyright lawyer to help you with the process.

What Should Be Copyrighted?
If the law allows, you should consider copyrighting, trademarking, or patenting the following elements of your business:

- Company name, logo, and motto
- Domain name
- Product designs
- Underlying technologies

Depending on your jurisdiction, you may also be able to protect confidential information, like trade secrets, processes, and procedures. In general, the following items cannot be copyrighted:

- Individual names
- Ideas that have not been implemented
- Generic designs and items (for example, a plain T-shirt)

Is It Worth It?

Establishing copyright, trademarks, and patents can be an expensive undertaking. Decide what is worth protecting and what is not. A copyright expert, industry expert, or mentor can help you with this.

Employee and Contractor Agreements

Ensure that all employee and contractor agreements explicitly state that your business retains copyright for any work that they do for you. Non-disclosure agreements may also be appropriate (depending on your business).

Further Reading:

- ✓ ***Mintzer, Richard. The Everything Project Management Book (2nd Edition). Adams Media Corporation, 2008.***
- ✓ ***Project Management Institute. A Guide to the Project Management Body of Knowledge (5th Edition). Project Management Institute, 2013.***