Financial analysis and planning

Financial analysis is an important part of the process of developing a business plan, and then for monitoring the success of that plan.

Typical elements of financial analysis include:

1. **Budgeting -** creating a budget setting out planned cash flows in and out of the business. By monitoring a cash flow budget it is possible to identify any potential crisis points where liquidity will be poor. Budgets can also be set out for income and expenditure by the business, as well as a capital budget showing major capital spending e.g. on premises, equipment etc.

2. **Profit and loss analysis -** this involves the creation of a profit and loss budget setting out expected future profits/losses for the business. This is important in assessing the return on the business. Useful parts of profitability analysis are:
* gross profit margins - the gross profit of the business as a percentage of sales.
* operating profit margins - operating profit as a percentage of sales.

3. **Solvency analysis** - involves calculating the net current assets of a business as shown in the balance sheet (i.e. current assets - current liabilities).

4. **Return on capital employed (ROCE)** - this is a measure of the return made on all of the capital employed in the business in a given period of time.

5. Where a business has shareholders it is useful to analyse returns to these shareholders in terms of returns for each £ invested in share capital.

Financial analysis is very important in planning because ultimately business success is measured in terms of money. Investors in a business need to feel that:
* their money is secure
* that their returns are comparable to what they can earn elsewhere
* that planners have a good sense of the financial implications of their actions.

Financial plan

Solvency refers to the ability of a business to be able to cover pressing financial claims - e.g. to pay wages, bills from suppliers etc.

Capital employed refers to both shareholders (owners) capital and capital raised from outside source such as banks.

In setting out a financial plan for a new business it is important to produce:
* an income and expenditure budget
* expected profit and loss account
* indicators of profit ratios
* cash flow estimates
* a capital budget.