

## FINANCIAL PLAN – BASIS FOR “YIELD (EARNING) METHODS” APPLICATION

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**Оцінювання компанії можна виконати багатьма способами. Одним із варіантів є використання методів оцінювання “за кінцевим результатом” та інструментарію, який полегшує оцінювання комплексного фінансового плану компанії. Для цієї мети можна використати офіційний фінансовий план компанії, укладений фінансовим менеджером компанії, або його власний план. За обох підходів фінансовий менеджер мусить бути добре інформованим про структуру фінансового плану, а також про індикатори оцінювання і моніторингу. Основний зміст цієї статті стосується опису згаданих вище аспектів фінансового планування.**

**Evaluation of the company is possible in many ways. One possibility is to apply evaluation methods, which are based on the yield (earning) methods and such tools, which make easily possible to evaluate the complex financial plan of the company. For these purposes it is possible to use the official financial plan of the company elaborated by the financial manager of the company or he can compile it on his own. In both approaches the financial manager must be well informed about the structure of the financial plan and also about inserted evaluation and monitoring indicators. The description of above mentioned aspects of financial planning are the core of this article.**

**What is financial planning.** Financial planning is the process including definition of financial aims of the company and list of disposals facilitating their achievement. Financial planning is integrating part of the company strategy and important tool of financial manager. The output of the financial planning is financial plan.

Financial plan is the document, where both actual and future situation of actually existing financial resources are presented as well as the future expected financial resources, which we intend to insert into the future cash flow.

Through the financial plan the company could verify the feasibility of the strategic decisions in particular plans and in financial plan there is also source of influence on effective use of production elements. Active role of the financial plan is based on the factual and value aspects of the transformation processes. In the course of decision making about the production and sales it is necessary to consider combination of production elements as well as factual and value aspects of transformation processes in the broader structure of mutual links. On the other hand, there are real products and real production with its quantitative and qualitative structure with the different level of efficiency.

Quality of financial plan is based on the mutual links among particular plans. Quality of the financial plan depends namely on the quality of correspondence between particular company plans (like marketing plan, production plan, planning of production inputs, technical development plan, human resources plan, financial plane etc.) [1–3].

Long-term financial plan contains financial decisions about long-term assets and liabilities, which is not feasible to cancel or change and which can influent the orientation of the company for many years ahead. There belongs e.i. decisions about the capital need (investment projects and their efficiency), ways of their financing (own and foreign capital resources) and decisions concerning the structure of overlapping the capital need. Long term decisions are more complex, than short term ones.

**Approaches to the creation of the financial plan structure.** The structure and content of financial plan can be selected by company or expert, but there must be mentioned at least these aims:

- Connection among particular plans
- Comprehensive plan of the company (horizontal links)
- Continuity between subsystems (vertical links)
- Cohesion to IT system (including accountancy)
- Statistic return system
- Information resource for investors, shareholders and creditors

Resource for system projection is in the definition of minimum objectives and characteristics of the company (size, type, structure of production etc.). Components of the long-term financial plan are as follows:

- Project of plan
- Plan of capital expenditures
- Project of dividend policy
- Balance sheet plan
- Profit plan
- Cash flow plan

The resources for long-term financial planning are in the financial aims, long-term sales plan, research and development plan and long-term projects.

Dominating part of the long-term financial plan is the project of company development and the project of capital expenses. The individual projects relate to the core activities and businesses of the company. Like example of the development or capital expenses plan contents it is possible to mention: new machines, technologies, reconstruction or new investment, new customers, marketing diversification, inventory and research or state order.

Under the capital expenditures we consider analysis and planning of capital expenditures in long-term period with the return period not longer that one year. Together with analysis of investment opportunities is necessary to decide about the structure and proportion of own and external financial capital. There is real need to consider also some of the ratios, like level of debts, dividend share, liquidity etc.

Decision about the division of profit is described in the plan of dividend policy. The function of the financial balance is to propose the financial situation of the company and together with the profit plan constitutes the basic information resource for the evaluation of the financial plan. The decision about the investment to the different types of assets and the ways of financing is in the hands of financial manager or financial expert.

For financial planning we can use as the starting point the actual balance sheet. The specifics of company could be expressed by the adjustment of non planned items and some items can be expressed in summary. In the long-term period it is possible to substitute individual items of the short-term assets and current liabilities by net working capital.

Problem of optimizing of the financial structure and dividend policy are solved in the subsystems of financial planning. Annual financial plan is only realization of these intentions. The really good financial manager must be able to manage as the plan of dividend policy, so to optimize the financial structure and to take decision leading to grow of market value of the company. All these items are affected by external causes.

The core function of the financial plan is planning of cost plus. The planning chart can be constructed in different shape and structure according to the expected balance between costs and revenues. There are two different approaches to the cost specification:

1. Physical approach, which divides costs into individual classes, in some resources we can find the attribution "**method of total costs**".

2. Functional approach, which divides the profit plan according to the different departments in the company (production, sales, administration). This method is called "**method of turn-over costs**".

There is not any legal or theoretical charge or advice for construction of planning charts. The shape and structure of planning chart must correspond with the characteristics of the company like size, type of

production, branch etc. For profit planning it is usually used the shape of profit and lost report. In the long-term profit planning it is valid, that development of individual cost and profit items can be substituted by the margin of profit planning.

The important component of financial plan is cash flow. Cash flow plan offers information about the future revenues and expenditures and about the final situation in the selected period. The objective of cash flow plan is to provide liquidity. Cash flow is related with the other particular company plans like sales plan, purchase plan, investment plan and others i.e. budgetary plan etc. The decision incorporated into the cash flow plan can influent directly the flows of cash and disposable cash. The substantial role of cash flow plan is in the profit planning. The long-term cash flow is connected with the projects realized by the company. Planning of long-term cash expenditures and revenues from sales is the base for healthy financial decisions and optimal exploitation of short- and log-term loans.

**Procedure of financial plan construction.** The construction of financial plan is possible to describe in the form of following steps:

- |          |                                     |
|----------|-------------------------------------|
| 1. step  | company character                   |
| 2. step  | financial analysis                  |
| 3. step  | planning of time schedule           |
| 4. step  | actual company mission and strategy |
| 5. step  | SWOT analysis of the company        |
| 6. step  | future expectations                 |
| 7. step  | formulation of aims                 |
| 8. step  | formulation of objectives           |
| 9. step  | planned projects                    |
| 10. step | long-term financial plan            |
| 11. step | short-term financial plan           |
| 12. step | budget                              |
| 13. step | evaluation of financial plan        |
| 14. step | indicators of plan performance      |

**Methods, techniques and models for financial plan construction.** Financial manager or expert can select for formation of financial plan from many different methods and techniques. The basic function of all these methods and techniques is to give information for elaboration of different variations of financial plan according the formulated aims and future expectations. There are no methods leading directly to the optimal or complex financial plan. Finding the solution is in the hands of financial manager or expert. In short we can tackle following specific methods:

- Method of percentage on incomes
- Method of financial ratios
- Method of step by step budgeting
- Regression method
- Analysis of neutral point
- Global method
- Financial modeling
  - Model of long-term financial plan
  - Simulation models
  - Optimizing models
  - Longer's model, Carlet's model, Waren-Shelton's model etc.

Specific methods for financial plan formation were developed by financial managers and they are mostly applied, with the exception of financial ratios. Financial ratios belong to the financial analysis methods. To the other methods of financial management we can include these models and methods:

- Models for optimizing the financial structure of the company
- Models of dividend policy
- Methods and models of working capital
- Methods of evaluation of the company efficiency
- Methods and models of capital financial investment

All these methods are applied for decision making about the future. Financial manager or expert usually connects these methods with the specific methods. Another segmentation of methods could be based on the time period, it means to take decision, which methods are more suitable for short- or long-term financial planning.

**Evaluation of the financial plan.** The integral part of financial plan composition is its evaluation. By the evaluation processes we can investigate future problems and also to appraise the quality of plan. Evaluation can answer the questions concerning the perspective and prospective company future or to recognize any issues with its realization.

For evaluation of financial plans are recommended the following methods:

- Ratios
- Altman’s model, or its modification for local circumstances
- Evaluation by objectives
- Economic standards
- Economic added value (EVA)

Using the ratios like rentability (ROI and ROA), liquidity, cost-effectiveness, debts, productivity or market value etc. we must select such ratios, which will be feasible to calculate and to quantify. It means all ratios have to correspond with the shape and structure of financial plan. For evaluation it is possible to compare calculated values with the prototypes. The function of prototypes can be taken from similar company in the similar period.

Use of the Altman’s model and calculation of “Z” score for share holder companies with quoted securities the calculation is visible from dependence:

$$Z = \frac{\text{net working capital}}{\text{assets}} \times 1,2 + \frac{\text{retained profit}}{\text{assets}} \times 1,4 + \frac{\text{operating profit}}{\text{assets}} \times 3,3 + \frac{\text{stock exchange value}}{\text{external gross debts}} \times 0,6 + \frac{\text{revenues}}{\text{assets}} \times 1 = \text{score "Z"}$$

The comparative values are presented in the Table 1:

*Table 1*

**Evaluation of the financial plan by “Altman” model**

<b>“Z” score in accordance with Altman</b>	<b>Probability of bankruptcy</b>
1,8 and less	Very high
1,9 – 2,7	High
2,8 – 2,9	Possible
3,0 and more	Not presumptive

Using Altman’s model we need not ever to apply evaluation chart, if the annual development of “Z” score is dynamic. Next method for financial plan evaluation is evaluation by objectives. This approach is suitable for SME’s, where the formulation of objectives is relatively easy and the financial plan is made for shorter period. For the first assessment of the financial plan the following economic standards are useful:

**Economic standard I:**

Profit > revenues from sales > material costs > wages > workers

**Economic standard II:**

Profit > revenues from sales > reserves

**Economic standard III:**

Profit > revenues from sales > corporal investment property > wages > workers

Assessment of financial plan is positive if following inequalities are true. The indicators are coming from the annual growth. The “EVA” indicator is the modern approach for measurement of company efficiency. This indicator is taken from the rule, that the production must exceed investment. By application of the economic added value the positive appraisal means that calculated value is positive and in the future period it will be the value of this indicator dynamically growth. Integral part of the financial plan could be the risk analysis (namely related to the company projects) and its consideration in constitution of discount rate.

*1. Kralovic J. Financial planning in companies. – Bratislava: ELITA, 1998. – 455 p. 2. Kralovic J., Vlachynsky, K. Financial management. – Bratislava: IURA EDITION, 2006. – 227 p. 3. Valach J. Financial management. – Praha: EKOPRESS, 1999. – 250 p.*