

THE SUBSTANTIATION OF CASH FLOWS WITHIN A BUSINESS PLAN

ILIE RĂSCOLEAN, ILEANA-SORINA RAKOS^{*}

ABSTRACT: *This paper highlights some aspects regarding the substantiation of the cash flows within an economic entity. The main objective is to highlight the cash inflows and outflows and the cash flow during the investment project. Based on the literature, the authors present the structure of the business plan that should include: medium and long-term vision and objectives; business description and implementation strategy; human resources policy; description of the investment project; financial projections and justification of the need to fund the project. The business plan is a predominant tool for managers - identifying funding sources, getting funding, or making partnerships with other companies. The business plan establishes the vision, objectives, implementation strategy and actions of the economic entities necessary to carry out profitable activities in the future. The authors try to contribute to the conceptual and empirical national and global framework on the substantiation of cash flows in a business.*

KEY WORDS: *market analysis, cash flows; financing; business plan; financial projections*

JEL CLASSIFICATIONS: *M21; O22.*

1. INTRODUCTION

In order to understand the concept of a business plan, we consider it useful to define the concept of a business, namely: an intention of a person (physical or legal) to undertake certain activities in order to obtain a profit. The theoretical and pragmatic approaches to the business plan differ from specialists to professionals, as evidenced by the existence, after the 1990s, of extensive literature in the field, as well as numerous issues published in various volumes, but also disseminated through the

^{*} Assoc. Prof., Ph.D., University of Petroșani, Romania ilierascolean@yahoo.com
Assist. Prof., Ph.D., University of Petroșani, Romania, nihilsinedeo_68@yahoo.com

online environment, including guides to develop business plans in various business areas.

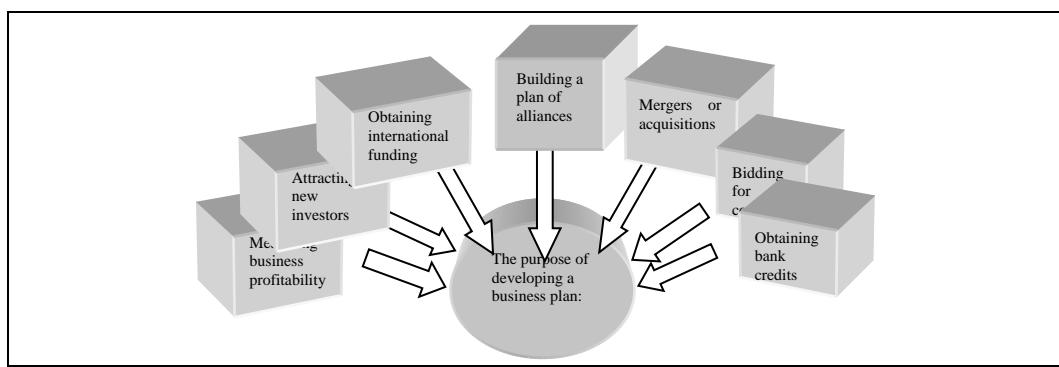
From the prestigious Harvard University, David Gumpert, (1990) realizes a realistic approach to the business plan that it is “a document that proves in a convincing manner that the business envisaged can sell enough products and services to produce a satisfactory profit and make it attractive to potential investors.”

The role of the Business Plan is to demonstrate that the business deserves to be funded and to guide the entrepreneur from the first year of operating the business, being in fact both an internal tool through which the manager manages and controls the entire process of starting an economic entity, as well as an external instrument that facilitates communication with the economic environment.

The Business Plan establishes: *vision, mission, goals, strategy and action plans for carrying out a specific activity during a determined future period, history, management, human, financial, and material resources, current activity, market analysis, cost analysis operation, necessary investments, financial projections and appendices there to, including: cash-flow forecasts; any other relevant financial information; detailed description of the product or service; plans and sketches for the technological process; a detailed list of equipment owned or to be purchased; description of the investment; Cvs of management; organization chart of the economic entity; brochures and advertising materials; copies of various contracts; support letters from future customers / pre-orders; suppliers' offers; results of marketing researches; operational plans; any other material that can provide relevant information to those who will read the business plan; a list of all the assets held, adjusting this list according to the economic entity profile and the size of the investment.*

Thus, the Business Plan “transmits” to all those around the entrepreneur - customers, suppliers, strategic partners, financiers, shareholders, that the manager knows for sure what to do, and in a functioning market economy, serious business partners appreciate this and they will perceive the entrepreneur as a pertinent actor of the economic environment.

Schematically, all these aspects are shown in Figure 1.



Source: own projection

Figure 1. The purpose of developing a Business Plan

In addition to the business plan, a set of financial statements detailing cash flow is essential. This will give details about the actual amounts of money requested by an economic entity, each day, from one month to another, and from one year to the next. The needs of a business are constantly changing, and the cash flow will highlight potential shortfalls in cash that will have to be moved. Good cash flow management is essential to a successful business. It is necessary to carefully analyze the products/services offered, the competition, the necessary financial resources and other operational details.

Also, the business plan is a working tool that is used to start and run a business that requires material, financial, and human resources. Through it, the experience and achievements of the past are used to design the future through the most appropriate methods of estimation and approximation. Implementing a Business Plan means control and adaptation - depending on real evolution. This control over the business will address all critical elements of the economic entity (inventories, production costs, quality control, sales, payments made, etc.). A realistic business plan always has two parts: a written part that analyzes the context (market, competition, trends) and a part that evaluates the operational and financial implications by preparing a future financial scenario (in an excel table). The Cash Flow is used to get the best value for money.

2. WHAT IS THE CASH FLOW?

The International Accounting Standard (IAS) 7 defines cash flows (also referred to as cash flows or cash-flow in some studies) as cash inflows or outflows and cash equivalents.

In business planning, the availability of money at the right time is a criterion that must first be taken into account when performing basic activities. The cash-flow of a business is one of the most important tools used by both managers and entrepreneurs, as well as by investors, in substantiating business decisions. Cash flow analysis is required in all economic forecasts, both for obtaining a bank credit and for financing a project through European or national non-reimbursable funds. The information provided by this cash flow analysis also serves specialists outside of the economic entity, such as:

- creditors - provide working capital and capital for investment, so they will be interested in recovering the borrowed funds;
- financiers - analyze the sustainability of the investment project over a certain time horizon, medium or long, being interested in how the company can sustain its activity without exhausting its financial resources;
- business consultants - will look at the evolution of the economic entity over a time horizon, medium or long term, being interested in all information regarding clear or estimated receivables and payments;
- investors - make the decision to attract participants into a new business, analyzing its ability to generate profit in the medium or long term.

In practice, the calculations are summed up on sources of income and costs, so if the revenue is higher than costs and profit is obtained then the investment seems appropriate.

Practically, the cash flow is the clearest picture of the health of a business, showing both the earnings and payments a company has in a period of time. The longer the time horizon, the accuracy of the information will be lower, taking into account various hypotheses whose accuracy will be lower. The most accurate information can be obtained over a time horizon of up to one year.

When the analyzed time period exceeds 12 months, the accuracy of the information decreases, which makes this financial analysis tool not be sufficiently precise and real. Of the changes that may occur during a year, we can mention: the change in the VAT rate, the gross minimum wage in the economy, the tax rates and local taxes, the turnover tax rates or the income of the microenterprises, and the legislative changes this year are evidence conclusive in this respect.

3. MAKING A CASH FLOW ANALYSIS

The main source for the analysis is the “Treasury Cash Flow Statement” prepared in accordance with the provisions of IAS 7, *mandatory* for large enterprises and *optional* in the case of small and medium-sized enterprises.

The overall framework for preparing and presenting the financial statements of which the “*treasury cash flow statement*” also states that their objective “is to provide information on the financial position, performance and changes in the financial position of the enterprise that are useful to a wide range of users in making economic decisions”.

The financial statement users include prospective and potential investors, hired staff, lenders, suppliers and other commercial creditors, customers, government and its institutions as well as the public. Regarding the “cash flow statement”, IAS 7 considers that it provides useful information for assessing the entity’s ability to generate cash, as well as its needs to use cash flows, respectively the timing and the safety of their generation.

In Romania, the *treasury cash flow statement* is considered a component of the annual financial statements in accordance with the International Accounting Standards.

Under the treasury cash flow scenario, according to the functional approach of the activities of an economic entity, the cash flow has three closely interconnected, so the result of one influences the others and, ultimately, the end result of the whole activity:

- the investment activity concerns the intention of the company to make new investments, acquiring goods and equipment, constructing, paying for software solutions etc;
- the financial activity refers to the procurement of the money resources necessary for the realization of the investments: loans from associates, bank credits, own sources or non-reimbursable funds;
- the (operational) exploitation activity carried out by the company in parallel with the realization of the investment.

The duration of the economic forecast differs according to the destination that the cash-flow will have, the duration of the analysis may be limited by the repayment period of the credit, in the case of financing from national or European funds it is five years, and for internal use it is designed for one year, which ensures high precision. The cash flow is compiled for three distinct components: the investment activity, financial actitiveness and operational activity.

The cash flow for the investment activity includes the following information: what are the necessary investments and what is their value? At what times will payments be made to suppliers? Will the investment be made within one month or is a breakdown needed over a longer period?

The cash flow for the financial activity refers to securing the financing sources from which the economic entity will support the investment. These sources can be:

- own financial sources when the entity is available from the prior period;
 - o loans or bank lines when the entity will lend the financial resources necessary to make an investment or to cover operational expenses;
 - o contribution of the associates or loans granted by them to the entity;
 - o European or national non-reimbursable funds when the company accesses such funding.

Often, the economic entities use a mix of four funding solutions. These cash inflows will also generate cash outflows:

- interest payments on contracted loans;
- repayments of contract credits;
- repayments of loans from shareholders.

The cash flow for operating activity is for the upcoming period, and it does not generate earnings or payments until the activity starts. If the activity is started, the cash flow will comprise two components, adding activities and the activity that is financed by the implementation of the investment project. This will generate a substantial increase in the company's workload when the investment is made to expand the range of products, services.

Operating revenue is: provision of services to the entity's customers; the sale of goods and products; carrying out works. VAT must be calculated if the entity is VAT-paying. Payments generated by exploitation are: for suppliers, for raw materials and material; for utilities; for the rent of the production hall or the office; for salaries and social contributions; taxes and duties owed to the budget; advertising and publicity.

The analysis of the cash flows on all three types of activities is useful for: correlating the profit (loss) with cash; the separation of cash-based activities from those that do not involve cash; assessing the ability of the entity to meet its cash payment obligations; cash flow assessment for future cash-flow activities. The usefulness of the analysis is given by the fact that the global variation of the treasury is evidenced by the treasury balance resulting from the real assets management (from operating activity) and from the capital-related investments and financing operations.

When real and monetary flows do not coincide, as it actually happens, the treasury is provided by pay mismatches associated with these flows.

Each of the three categories of flows has an impact on a source or use of liquidity. While respecting the American accounting tradition, operating cash flows can be determined either directly or indirectly, and cash flows from investing and financing activities by direct method. According to the direct method, gross cash receipts and payments are used, and the peculiarity of the indirect method is that the net profit (or net loss) is adjusted with the effects of non-monetary transactions, deferrals or payment commitments or receipts in cash from past or future operations and the items of income and expense associated with cash flows from investment or financing activities.

Although they lead to the same results, IAS 7 recommends entities to present cash flows through the straight line method because it provides useful information in estimating future cash flows that the indirect method can't provide.

Therefore, the cash-flow can be positive or negative, which is explained as follows: if the money entering an economic entity is more numerous than the ones going out, then we are talking about a positive cash-flow. Positive cash flow is a very good thing for the entity and the only problem is managing this surplus. In the reverse situation, that is, when the money coming out of the entity is more than the one entering the negative cash-flow. The negative cash-flow can be caused - for example - by the timely non-collection of money from customers, in which case quick solutions must be found to avoid the company's inability to pay.

Also, making a cash flow analysis of an economic entity's business requires a thorough knowledge of the business and the collection of all necessary information on the proceeds and payments to be made in the future. The information to be collected is related to:

- the number of staff employed and estimated to be employed and the expenses of the entity are salaries and social contributions for both existing and those who will be hired during the analysis period;
- the structure and value of other business expenses (rents, utilities, raw materials, third parties etc.);
- realization of planned investments for the next period; the maximum production capacity of the entity and the degree of effective use of the entity; contracting of credits and conditions under which they will be repaid (interest rate, grace period, duration of credit, etc.);
- forming the sale price, the granting of volume or pre-maturity discounts etc.

For the collection of these data, a questionnaire will be made which will be sent to all persons able to provide the requested information, stating that the information can be extracted from the following documents:

- financial statements for the previous or previous months;
- staffing needs;
- revenue and expenditure budget for the following period;
- the investment plan;
- financial offers of equipment to determine the value of the investment;

- technical offers of equipment to determine future production capacity, energy consumption, fuel, etc. what these are supposed to do etc.

When calculating the cash flow, the amortization expense is not taken into account. This is not an expense involving liquidity outflows within the entity, being a way in which the entity may constitute the financial resources necessary for the future replacement of fixed assets at the end of the normal period of operation. In a cash-flow analysis, it is very important when the company collects receipts and when the company makes payments. For example, if an economic entity purchases raw materials with a negotiated three-month payment, cash outflows will not be evidenced at the time of signing the contract or at the time of delivery, but at the time of actual payment.

This reasoning also applies to cash inflows from the sale of goods, provision of services, etc. A negative disposition at the end of a period (day, week, month, quarter, semester, year, etc.) means that the economic entity does not have sufficient financial resources to cover current payments at that time. In this case, working hypotheses need to be redefined, taking into account the delay in paying suppliers or quickly collecting invoices issued to customers, while offering some trade discounts.

4. CASE STUDY

A Limited Liability Company (LLC) is set up, with a share capital of 200 lei, with a single associate, also having the capacity of administrator. For the forecast period, the company falls into the category of micro-enterprises with incomes less than 1000000 euro equivalent in lei during a financial year. In order to start and carry out specific productive activities, the following sources of funding are sought:

- non-reimbursable funds partially covering the initial investment amounting to 150000 lei;
- a 5-year bank loan in the amount of 30000 lei with an annual interest rate of 10%;
- in addition, the single associate lends to the commercial company the sum of 20000 lei, and the loan is to be repaid from the liquidities generated by the profitable activity carried out after the commissioning of the investment project.

The initial value of the investment project is 200,000 lei, including the following: production hall, equipment necessary for the technological flow, provision of the necessary utilities, means of transport, offices for the administrative headquarters.

Funding sources provide funding for the investment project and cover current expenses for three months from the start of the business and partly for the next three months. Starting with the seventh month, the expenses will be fully covered by the proceeds from the sale of the production.

The cash flow for the first seven months of starting business and forecasts for the next two years are shown in the table below.

Table 1. Cash Flow

Explanations / month	Period of implementation							Period of prognosis	
	L7	L8	L9	L10	L11	L12	2018	2019	2020
Initially available balance (home and bank)	200	198300	31342	16042	3645	4713	200	4980.5	4644.5
Cash inflows through:	200000	0	0	0	0	0	200000	0	0
Loans from associates / shareholders	20000	0	0	0	0	0	20000	0	0
Long-term credits	30000	0	0	0	0	0	30000	0	0
Non-reimbursable financial assistance	150000	0	0	0	0	0	150000	0	0
Investment liquidity outflows:	0	200000	0	0	0	0	200000	0	0
Purchase of tangible assets, including VAT	0	190000	0	0	0	0	190000	0	0
Acquisition of intangible assets, including VAT	0	10000	0	0	0	0	10000	0	0
Outflows of financing liquidity:	0	3500	3450	3400	3350	3300	17000	35700	28500
Credit reimbursements	0	500	500	500	500	500	2500	6000	6000
Interest payments	0	3000	2950	2900	2850	2800	14500	29700	22500
Cash inflows through:	0	0	0	10000	25500	27000	62500	315000	410000
Sales of goods and services, including VAT	0	0	0	10000	25500	27000	62500	315000	410000
Outflows of liquidity through:	1900	1800	11850	17400	17700	20250	70900	225618	283000
Expenditure on raw materials and consumables	0	0	0	5000	5500	8000	18500	34500	65000
Staff expenditure	0	0	10000	10000	10000	10000	40000	140000	190000
Rent	1500	1500	1500	1500	1500	1500	9000	18000	20000
Utilities	100	100	100	500	500	500	1800	6000	6000
Other expenses	300	200	250	400	200	250	1600	1800	2000
VAT payments	0	0	0	1597	3382	3182.5	8161.5	48393	60230
VAT rebates		38342	0	0	0	0.	38342	0	0
Profit / turnover tax	0	0	0	0	0	0.	0	625	3150
Dividends	0	0	0	0	0	0.	0	5000	15000
Total payments exclusive to exploitation	0	-38342	0	1597	3382	3182.5	-30180.5	54018	78380
Cash flow from operating activities	-1900	36542	-11850	-8997	4418	3567.5	21780.5	35364.	48620
Net cash flow of the period	198100	-166958	-15300	-12397	1068	267.5	4780.5	-336	20120
Final balance available at the end of the period	198300	31342	16042	3645	4713	4980.5	4980.5	4644.5	24764.5

Source: own projection

5. CONCLUSIONS

The cash flow forecasts are an important tool for leading an economic entity that can help in general business planning. In addition, the effort made to realize the forecasts will be useful as a good starting point for possible detailed discussions with the credit officer in the case of bank loan withdrawals. Without the cash there is a safe way of ending the activity of the economic entity and respectively towards insolvency, which is why it is necessary to give due importance to flows that represent cash inflows or outflows.

The cash flow shows the cash movements of an entity over a certain period of time, this being the spring that makes the business go. A number of companies go bankrupt because they are not concerned about cash flow management so they can secure enough cash to honour their due obligations. Cash flow management means the tracking and forecasting of cash inflows and outflows so as to ensure the exact amount of cash needed to deal with outstanding payments at the time the payments become due.

It is important for entrepreneurs and managers to understand that focusing solely on sales volume DOES NOT ensure the sustainable success of the economic entity, which must be operationally effective and manage its financial flows with fairness.

The forecasted cash flow involves estimating all the sources and future cash uses of an economic entity, depending on the strategy the entrepreneur proposes, namely: the target of increasing the volume of sales, the concluded business contracts and the payment terms, the policy the human resources, the location in which they operate, the financial resources they have or intend to attract, the seasonality of the business, the taxation, etc. It can be run monthly, quarterly, semi-annually or annually, and takes into account the trend in the past, the expected changes in the operational cycle, investment policy, financing contract features, seasonality, and last but not least, environmental changes business, politics or taxation.

The fact that an economic entity is profitable is not a sufficient condition for the firm to remain solvent. A bad debt collection policy or an inappropriate managerial decision about continued output on the stock - may generate a profit accounting position, but lacking the cash needed to resume the production cycle and invest. When an economic entity does not have sufficient cash to honour its maturity, it becomes insolvent.

The case study presents the cash flow for a newly established trading company that has three categories of funding sources: non-reimbursable funds, bank loans, and the single associate's contribution.

The mentioned sources of funding ensure the realization of the investment project necessary for carrying out productive activities and covering some operating expenses in the first months of the activity. There is a positive cash flow generated by the profitable activity that makes it possible to make payments related to the exploitation cycle from the collection of the income from the sale of the production.

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