

## FINANCIAL PLANNING

- A financial plan is a statement of what is to be done in the future. Most decisions have a long lead time, which means they take a long time to implement.
- Long range planning is a means of systematically thinking about the future and anticipating possible problem before they arise.
- Financial planning formulates the way financial goals are to be achieved.
- Financial planning establishes a guideline for change and growth in a firm. It normally focuses on the “big picture”. Thus it is concerned with the major element of a firm’s financial and investment policies.
- Thus, financial planning forces the company to think about goals.
- Lack of effective long-range planning is a commonly cited reason for financial distress and failure.
- Financial planners have six P’s. Proper, Prior, Planning, Prevent, Poor, Performance.
- There is a direct connection between the growth a company can achieve and its financial policy.

## **Dimensions of financial planning**

The future comprises of two aspects: short run and long run.

The short run is a period of a maximum of 12 months. The long-run focuses on a long period of time i.e. two to five years. This is known as planning horizons.

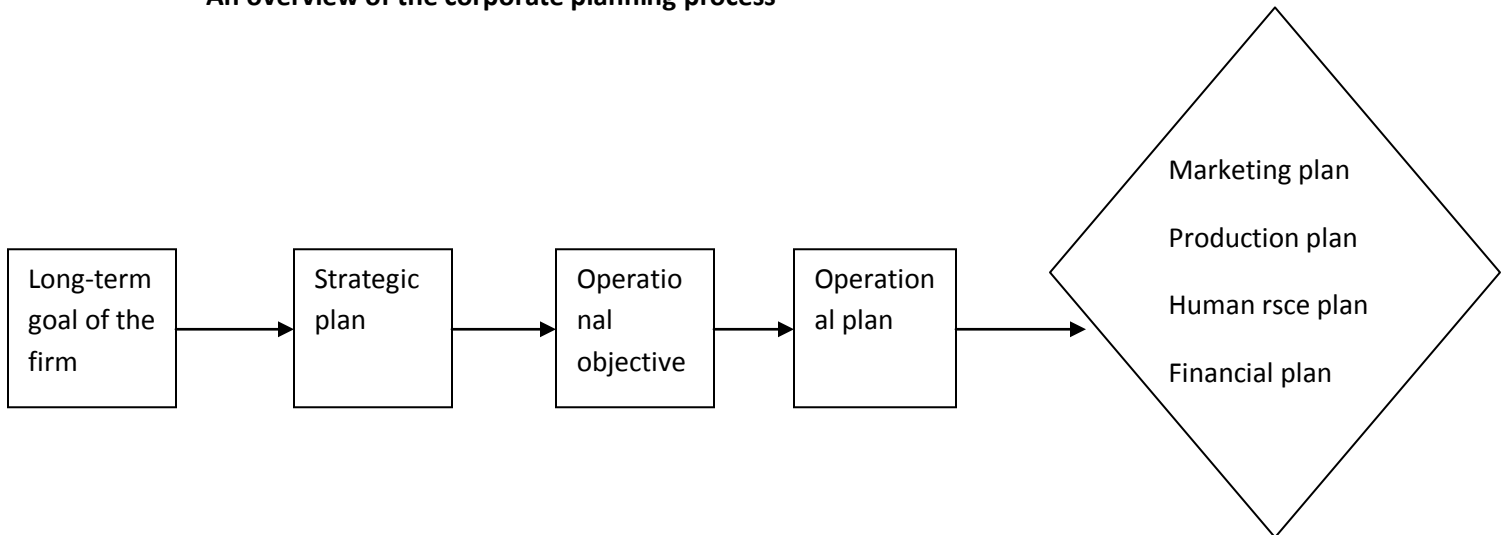
In drawing up a financial plan, all the individual projects and investments the firm will undertake are combined to determine the total investment needed.

The financial planning process might require each division to prepare three alternative business plans for the next three years.

- (i) A worst case: This plan would require making relatively pessimistic assumptions about the company's products and the state of the economy. This kind of disaster planning would emphasize a division's ability to withstand significant economic adversity, and it would require details concerning cost cutting, even divestiture and liquidation.
- (ii) A normal case: this plan would require making most likely assumptions about the company and the economy.
- (iii) A best case: each division would be required to work out a case based on optimistic assumptions. It could involve new products and expansion, and then would detail the financing needed to fund the expansion.

In this example, business activities are aggregated along divisional lines and the planning horizon is three years.

## An overview of the corporate planning process



- As described by corporate planning process, the strategic plan is determined by the long term goals of the firm, but it also affects the operational objective of the firms.
- The operational objectives in firms are implemented via the operational plan which consists of marketing, production, human resources and financial plans.
- To address these objectives, the firm must develop an operational plan, which consists of a marketing plan, a production plan and a financial plan.
- The marketing plan lays out the marketing resources needed to meet the operational objectives and includes such things as advertising strategy, marketing promotions, channels of distributions and distribution incentives, and assignment of sales territory.
- The production plan consists of facilities needed to achieve the operational objectives including the number of shifts plant refurbishment and expansions, vendor and supplies arrangement, inventory control e.t.c.
- The human resource plan is concerned with the personnel aspect of the objective. It looks at the managerial and labor pool that is needed to attain the objective.
- The financial plan lays out the financial resources that are needed to achieve the operational (including the financial) objectives of the firm.
- Operational planning is crucial to a firm's survival in the short and long run.
- The lack of adequate operational planning has doomed many firms both small and large.

## The process of FINANCIAL PLANNING

Developing financial plan for a company is like developing a personal financial plan.

One must figure out how much money is needed, when money is need and where it will come from.

The process consists of five basic steps:

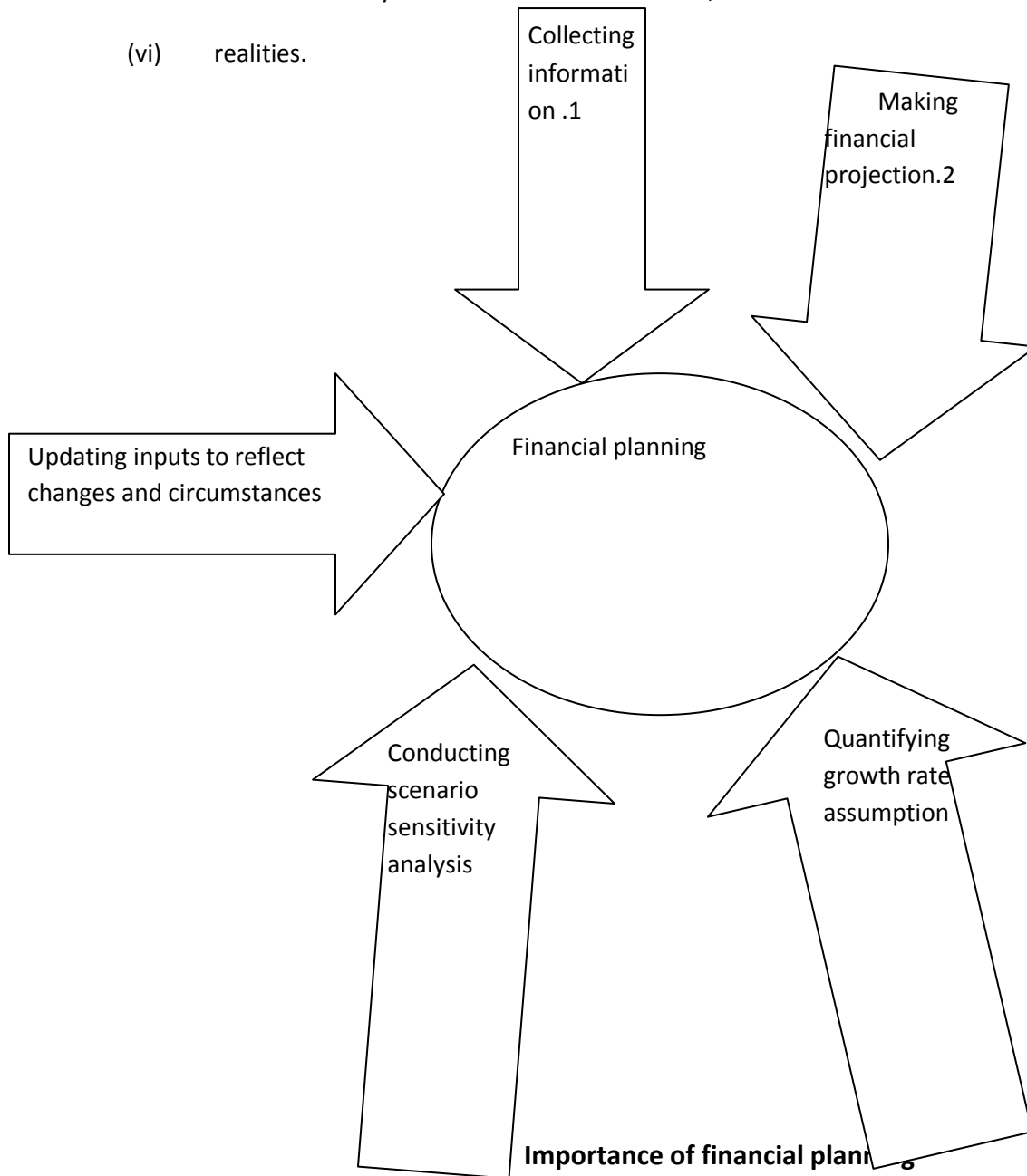
1. Estimating the month-by-month flow of funds out of the business, including both operating expenses and capital investments
2. Estimate the month-by-month flow of funds into the business from all sources
3. Compare inflows and outflows. If surplus funds exist, determine how to use those funds most productively. If funding falls short, find ways to reduce outflows and increase inflows
4. If outside funding will be required, analyze alternative sources and select the most cost-effective combination
5. Establish a system for tracking the flow of funds and measuring the return on investment

For investors along the entire wealth spectrum, financial planning can bring discipline, order, and reliability to thinking about and preparing for the future.

In a corporate set up, financial planning refers to the process of

- (i) Collecting information about the investors' assets, liabilities, income, spending and cash flows.
- (ii) Integrating these data into asset of financial projections.
- (iii) Making assumptions and quantifying them about growth rates in income, expenditure, cash flow, assets and liability values, and the tax environment.

- (iv) Reviewing the originally projected outcomes and various what if scenarios that may be affected by meaningful alterations in any of the key assumptions and forecasts and;
- (v) Periodically updating the inputs and output of the financial plan to reflect changes in the investors' family and economic circumstances, the financial market outlook, and tax realities.
- (vi) realities.



## Importance of financial planning

Financial planning can help investors in several ways:

1. It can provide a structural framework for organizing and dealing with wealth in any of its three embodiments;
  - (i) As a significant change in circumstances, though such means as inheritance, the sale at public offering of an ownership position in a business, retirement with large sum in various forms as self directed pension plans, award from loyal judgments, lottery winning or other sources.
  - (ii) As a projected accumulation of income flows versus expenditure flows over a span of years.
  - (iii) As an already existing established fortune in any of several forms, including real estates, livestock, boats, aircraft, other real properties, art, antiques, jewelry collections and various kinds of financial assets.
2. Financial planning can provide investors with a more comprehensive understanding of the roles and effects of time in achieving established goals and objectives, such as funding educational expenses, affecting inter generational wealth transfers, beginning to receive social security benefits and meeting retirement spending targets, and donating assets and/ or income flows to philanthropic institutions.
3. Avoiding surprises.

Financial planning should identify what may happen to the firm if different events take place i.e. it should address which corrections' the firm will take if things go seriously wrong or if assumptions made today about future have an error.

4. Financial planning derives from the arrays of information, choices and decisions that surface before the investors.

Financial planning leads the investors to consider key subjects such as:

- (i) The forms, amounts, vehicles and beneficiaries of life, property, long-term care, medical and disability-insurance coverage.
- (ii) The type, duration, conditions, supporting organizations, and family limited partnership.
- (iii) For business owners/ or self-employed, succession, retirement planning, insurance, and funding buy-sell agreements.
- (iv) The size and timing of tax payments including income, capital gains, estate, gift property, and other taxes at the local state, federal and in some cases, at the international level.
- (v) The use, timing, the structure of qualified Domestic Reliant Orders (QDROS), employer-furnished benefits, and pension and retirement-account inflows and outflows.
- (vi) The casts, conditions, magnitudes, and risks of borrowing and other forms of explicit and contingent liabilities.

(vii) Having an updated will and estate plan. These assessments provide the investors and his or her sources of financial and legal counsel with an integrated, consistent platform for making investors recommendations and decisions.

5. Increasing awareness of the potential needs, to make decisions that balance tradeoffs between various financial objectives.
6. Timely attention devoted to important monetary and personal issues well in advance of their reaching a critical stat
7. Examining interactions. Financial plan must make explicit linkages between investment proposal for the different operating activities of the firm and the financing choices available to the firm.
8. Exploring option. Financial plan provides the opportunity for the firm to develop, analyze and compare many different scenarios in a consistent way. Various investment and financing options can be explored, and their impact on the firms' shareholders can be evaluated.

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