Chapter 9

Cash forecasting, business planning and management control

Battle plans rarely survive the first encounter with the enemy. (Anon.)

Introduction

This chapter forms a bridge between your studies of financial accounting in Chapters 1–7 and the practical problems of management accounting within the firm. In this chapter, we discuss the role of business planning in establishing and running a business and the basic process for constructing a business plan. This description of the business planning process is designed to help you bring together the various components of a business idea and construct a working proposal that can be used to raise finance or, just as important, to organise and control a business. From the accounting point of view, the main output of the business planning process is the creation of a financial plan for a number of years into the future. At the centre of that financial plan is the cash flow forecast. That forecast is designed to capture within a statement the financial consequences of the firm's current strategic plans, taking into account both how it expects to earn its money and how it intends to spend it. We will demonstrate how such a cash flow forecast can be prepared.

Business planning is not just about business start-ups. Many firms use it as an ongoing discipline by creating a 'master plan' which is regularly reviewed and updated. This process enables senior management to construct and agree 'budgets' with the other employees of the organisation. In this chapter we will explain the different ways that budgets can be created, agreed and monitored as the business proceeds through its financial year. We also address the human and organisational issues in budgeting and in particular consider the problems of gaining compliance and enhancing motivation towards the firm's goals throughout the organisation. Finally, we will turn our attention to the techniques of variance analysis and control where management extracts the differences between budgeted and actual performance and acts to correct significant variations between what was expected and what was achieved.

Learning objectives

In this chapter we cover a range of learning objectives over three headings:

The business planning process

- To understand the business planning process and the role of the financial plan.
- To know the structure and purpose of the principal components of a financial plan.

Business planning in practice

- To be able to identify the most appropriate planning period for a firm.
- Using the principal financial policy variables to be able to project a cash flow statement and summary financial figures for a whole business or part of a business.

Budgeting methodologies and variance analysis

- To understand and be able to advise on the most appropriate budgeting methodology for a firm and be aware of the multiple purposes that budgeting fulfils.
- To be able to prepare and understand the significance of a range of revenue and cost variance measures.

The business planning process

Business planning is vital whenever a proposal is put forward for funding internally to a board of directors or externally, in the case of a start-up, to banks, venture capitalists or, in the case of a public flotation, through a prospectus. Existing businesses can make use of the planning approach as a basis for the long-term management control of the firm. It is important to construct a business plan whenever:

- a new business is to be formed and capital is required
- a new investment project is being proposed and a maximum capital need must be specified
- a new product line or project is being proposed
- a company 'floats' its shares on the stock exchange.

A business plan consists of a number of integrated elements covering the product or business proposal, the objectives that the company or proposer wishes to achieve, the strategy for delivering those objectives, and a range of marketing and organisational issues that flow from the strategy described. All of this will then be summarised into a financial plan that lays out the implications of the proposal in terms of cash flow, financial requirements, projected financial statements and a range of planning ratios and financial performance targets. Later