Blended Value Business Plan
Pro Forma Income Statement
User Guide

OVERVIEW

A business plan goes beyond the forecasting of a Feasibility Study. It provides details on the multiple factors required to develop a social enterprise (SE) and can be used as a planning tool by the management team or presented to a potential investor.

The Pro Forma Income Statement is a summary listing of the revenue and expenses generated by the enterprise activity in a specific time period. Generally the time frame for a Pro Forma Income Statement in a Business Plan is three fiscal years. In the planning stage, financial statements are called 'Pro Forma,' which means they show what is expected. This document can also be referred to as the Profit and Loss Statement.

The Income Statement is only one of many documents that will be used to plan and operate your social enterprise. Additional spreadsheets you will need:

- a detailed Start-up Costs budget;
- a Pricing Formula;
- Sales Forecast;
- a Budget;
- Cash-Flow Forecast;
- a Break-Even Analysis; and
- a Balance Sheet.

Information included in these documents will support the development of your Pro Forma Income Statement.

The structure of enp's Pro Forma Income Statement can also be referred to as 'The Double Bottom Line Report.' It is different from other Pro Forma Income Statements in two important ways. 1) It separates and clarifies the income and costs specific to the business activity from the income and costs related to the mission objectives of the enterprise. 2) It recognizes and tracks support to the enterprise that does not involve cash transactions. These are referred to as In-Kind Contributions or Hidden Costs.

For planning purposes and to understand the potential of the SE's long-term sustainability, it is important to separate the different cost centres which are : Business Income/Expenses; Mission Income/Expenses and In-Kind Contributions and Expenses.

This User Guide was designed to be used with the spreadsheet template <u>'Blended Value Business Plan, Pro Forma Income Statement'.</u> These materials will support you in customizing the spreadsheet to the specific enterprise you are developing. **The spreadsheet template**

provides you with the format for a Blended Value Income Statement but you will need to tailor it to include income and expense line items specific to your unique social enterprise.

A '% of Total' column is included in the spreadsheet as a tool to quickly reference the various levels of income and expenses each line item contributes to the total income and expenses of your social enterprise.

BUSINESS INCOME AND EXPENSES

The figures in this section, both income and expenses, are specific and limited to the business activities of the enterprise.

BUSINESS INCOME

The financial information included in this section is limited to: Earned income (A) ; Cost of Earned Income (B); Gross Margin (C) and Financing (D).

Earned Income
The cash value generated from the sale of the products and/or services sold by the SE.

Gross Sales - Product
The total cash value received for the product or products sold by your enterprise. If your enterprise sells more than one product it is recommended to track the sales of each product separately.

Gross Sales- Service
The total cash value received for the service or services sold by your enterprise. If your enterprise sells more than one service it is recommended to track the sales of each service separately.

Sub-Total Gross Sales (A)
The combined cash value from the sale of all products and services.

Cost of Earned Income
Included in the Cost of Earned Income are those costs that are directly incurred to sell a product or service; also referred to as Cost of Goods Sold (COS). Examples of these costs include: raw materials; inventory; shipping and direct labour. It <u>excludes</u> overhead or other indirect costs.

Sub-Total Cost of Earned Income (B)
The total of all expenses directly related to the sale of products or services.

Gross Margin (C)

The Gross Margin is calculated by subtracting Earned Income (A) from Cost of Earned Income (B). This is a key figure that provides insight into the basic profitability of your product or service.

Financing
These are cash receipts that are not related to the sale of goods or services. Most often this type of income is a result of a financing transaction. Examples include: business loan; interest income; use of credit.

Sub-Total Financing (D)
The total cash value of all financing that was received by the enterprise.

Total Business Income (E)
This figure is calculated by adding the Gross Margin (C) to the Total Financing (D).

BUSINESS EXPENSES

Fixed Business Expenses
This type of expense is paid regardless of the level of sales activity.

<u>Direct Costs</u>
These are costs that can be traced directly and easily to the business activity with a high degree of accuracy. Examples of direct costs include: management and staff salaries, facility rent and maintenance; tools and amortization of capital assets; and insurance.

Sub-Total Direct Costs (G)
The total cash value of all the Direct Costs that were incurred by the enterprise.

<u>Indirect Costs</u>
These are costs that are integral to running the business but cannot be readily tied to a particular activity or input. In an organization where overheads and other indirect costs are shared among a number of programs and activities, a reasonable mechanism should be determined to fairly distribute these shared costs to properly reflect the true cost to each program and activity. Examples of Indirect Costs: heat, electricity, telephone; administration and accounting; marketing; portion of governance and strategic development costs; portion of general fundraising activities, and banking and finance charges.

Sub-Total Indirect Costs (H)
The total cash value of all the Indirect Costs that were incurred by the enterprise.

Sub-Total Fixed Business Expenses (F)
Add the total of Direct Costs (G) to Indirect Costs (H).

Variable Business Expenses

These are expenses that vary in direct relation to the level of your sales activity. A few examples of variable expenses are your raw materials, wages, commissions and delivery costs.

Sub-Total Variable Business Expenses (J)
Add the total of all Variable Costs.

Total Business Expenses (K)
Add the total of Fixed Expenses (F) to Variable Expenses (J).

Net Business Profit/(Loss) (Z)
To calculate the Net Business Profit/(Loss) subtract the Total Business Income (E) from Total Business Expenses (K).

MISSION INCOME AND EXPENSES

Differentiating mission or social income and expenses from pure business income and expenses can help you to better plan and manage the multiple bottom-lines of the social enterprise. Mission income and expenses are related specifically to pursuing your mission and distinguish your social enterprise from a standard business.

Social enterprises differentiate mission and business expenses for many reasons.

- Recognize and promote differences in management decisions around business and social programs
- Assess business strategies and sustainability
- Compare business performance to industry and mission performance to other community organizations
- Develop a better understanding of an organization's required revenue mix (sales and grants)
- Determine the best ways to cover social costs
- Quantify the extra resources needed to support social objectives in order to make a case for government or funder investment in the event of an operating shortfall
- Provide the ability to weigh social costs against estimates of social impact as a way to better assess the effectiveness and efficiency of the enterprise model as a means to achieve social goals
- Assess competitive strategy in the business sector

Mission Income
Sources of income that support the social mandate of the enterprise that may or may not be available in the long-term. Examples include: grants; sponsorships; donations; and proceeds from fundraisers.

Sub-Total Mission Income (L)
The total cash value of all sources of Mission Income received by the enterprise.

Mission Expenses
Mission or social costs are premiums or additional costs incurred above and beyond normal business expenses due to the social, environmental and/or cultural mandate of the enterprise. It can be challenging to determine exact figures on these costs and may require you to make a best estimate. The estimates will become more accurate over time and will be helpful to get the 'true cost' of the enterprise. Examples include: wage premiums; lower productivity; additional training and support; discounted pricing.

Sub-Total Mission Expenses (M)
The total cash value of the Mission Costs incurred by the enterprise.

Net Mission Income/Expenses (Y)
This figure is calculated by subtracting the Total Mission Income (L) from the total Mission Expenses (M).

Net profit after Mission Income/Costs (X)
This calculation will allow you to identify the relationship of the business activity to the mission objectives of your social enterprise. It is determined by adding the Net Business Profit/Loss figure (Z) to the Net Mission Income/Expenses figure (Y).

IN-KIND CONTRIBUTIONS AND HIDDEN EXPENSES

In-Kind Contributions
The non-cash contributions that are integral components of your business activity need to be recognized and accounted for in order to reflect the 'true cost' of your social enterprise. This is particularly important when determining a competitive pricing policy or future funding needs to sustain your business in the long-term. The following criteria must be applied to determine which contributions need to be recognized:

- Goods or services that must be used in the normal course of your business, that you would have purchased if they were not otherwise provided
- A fair (market) value can be reasonably estimated
- Costs that may be significant to your decision-making process

Examples of In-Kind Contributions: volunteer staff or discounted services; discounted or donated goods and materials; donated equipment.

Sub-Total In-Kind Contributions (N)
The total cash value of all the In-Kind contributions to the enterprise.

Hidden Expenses

These are resources used or costs incurred in the normal course of business that are not directly paid for by the enterprise. Examples of hidden costs include: volunteer hours; donated materials/services and subsidized rent.

Support from the parent organization is also considered a Hidden Expense and needs to be included in this calculation. Examples of Parent Organization Contributions include: shared receptionist service; advertising; website design; office supplies; accounting services; shared management staff and use of the printer/copier.

Sub-Total Hidden Expenses (P)
The total cash value of all the Hidden Costs incurred by the enterprise.

Net In-Kind Contributions/Hidden Expenses (Q)
This figure is calculated by subtracting In-Kind Contributions (N) from Hidden Expenses (P). It is possible that the value assigned to the In-Kind Contributions will equal the value of the Hidden Expenses, resulting in a zero sum for this cost centre. For example, the In-Kind Contribution of volunteer hours has been calculated to be a cash value of $1,000, the Hidden Expense for volunteer hours should also be recorded at $1,000. It may seem that tracking and assigning a dollar figure for this cost centre is redundant but it is an important exercise to recognize what you would have to pay for these line items if they were no longer available as an In-Kind Contribution.

Net Profit after In-Kind Contributions/Hidden Expenses (R)
This calculation will allow you to recognize the relationship of the business activity with both mission objectives and the In-Kind Contributions and Hidden Costs of your enterprise. To identify this figure add the Net profit after Mission Income/ Costs (X) to the Net In-Kind contributions/Hidden Costs (Q).

Financial Sustainability

This section is not found in the traditional Income Statement format but it provides an opportunity for your organization to monitor the development of the long-term sustainability of your social enterprise. It is a quick summary of all sources of income and costs, as well as the percentage of each cost centre’s contribution to the total income and costs. This spreadsheet will be completed automatically once you have added numbers to the other three spreadsheets in this series: Projected, Best Case and Worst Case.

Once the financials goals of the enterprise have been identified, the figures in this section will provide the ability to monitor the income and cost figures in relation to the various cost centres and the social enterprise goals.

Contribution/Cost to Parent Organization

It is important for social enterprises that operate under the umbrella of a parent organization to monitor the impact that enterprise has on the parent organization – positive or negative.

While some social enterprises draw resources from their parent organization, others generate a surplus and contribute funds to the parent organization's operations. With either scenario this section provides an important opportunity to identify the relationship between the parent organization and the social enterprise.

Total Contribution to Parent Organization
If your social enterprise generates a cash surplus, discussions should take place to determine what will happen with the surplus. Some questions to consider:

- Does the enterprise require an investment in equipment or maintenance?
- Does the Parent Organization require a cash contribution to address budget shortfalls?
- Can the surplus be used to strengthen our response to our mission objectives?

Total Cost to Parent Organization
When the parent organization has contributed to the start-up and operations of the enterprise it should be determined if these funds will be returned to the parent organization once the enterprise starts generating a surplus.

ASSUMPTIONS

It is important to declare any assumptions you have made so the reader is aware how the figures were calculated. An example of an assumption: 50 people will purchase Product 1 at a rate of $5 per item per week. Therefore the monthly Sales Forecast for Product 1 is $1,000 (50 items X $5/item X 4 weeks).

Financial Goals

A social enterprise may have profitability as its goal, or it may not. As an SE it is important to be clear about your financial goals and to interpret your financial statements accordingly. In summary these goals could be:

Self-Sufficiency: Business revenues will cover all expenses.

Profitability: Business revenues will exceed expenses. A profit target could be defined.

Contribution: Business revenues may cover the business expenses, but not the social costs associated with your mission. This type of social enterprise will require some form of funding support to address the shortfall.

SENSITIVITY ANALYSIS

This is a crucial exercise to help determine how your projections may vary when changes are made to the assumptions you are using. This process allows you to identify the financial impacts when outcomes vary from your best estimate and prepares you to manage a change in circumstances. Understanding the range and impacts of other potential and reasonable scenarios is just as important as the particular projection you have selected to make.

Ask yourself two key questions:

1) How far off can I be on my original projections and still make an adequate return?

2) What would be the impact of being off, and by what amount, on this or that key assumption? Key assumptions can include – but are not limited to – the amount of revenue generated by sales and the cost of labour.

To conduct the Sensitivity Analysis, prepare three sets of financial statements for each fiscal year that you have in your business plan:

Projected Estimate: The figures that you have established based on your research.

Best Case Estimate: Assume a combination of positive events by increasing your key assumptions around income by a reasonable percentage and/or reducing the expenses related to some of your key costs by a reasonable percentage.

Worst Case Estimate: Assume a combination of negative events by reducing your key assumptions around income by a reasonable percentage and/or increasing the expenses related to some of your key costs by a reasonable percentage.

Additional Information Sources:

www.enterprisingnonprofits.ca

On this website is a free downloadable version of the enterprising non-profits 'The Canadian Social Enterprise Guide', second edition.

www.demonstratingvalue.org

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