

## PROFESSIONAL FINANCES

### MASTERFUL PLAN OF VALUE GENERATION

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All enterprise activity has as objective the value generation (whichever is the criterion and the form of distribution), reason why it prevails to work with a system that allows to elaborate a plan of profits. These must be sufficient to cover the cost with capital of the company and of producing excessive for the shareholders, that is to say, TO GENERATE VALUE.

Actually establishing it is very difficult from a program of this type. The theory of the planning of profits is described in a few pages; it is explained in a few hours, but the learning in the enterprise scope takes approximately five years depending on the development of the executive group and the managing capacity.

The mastery of the technique requires constant work, patience, critical spirit and a capacity of analysis that allows for the improvement of the methodology. First of all, it is important to create an atmosphere of planning in all the executives, which is due to look for through persuasion. It displeases people to be measured, to keep an expenses control, of fulfillment requests of a budget, etc. Experience demonstrates that little by little people comply with this discipline.

The highest levels of enterprise direction must take the subject positively and become pillars of the administration for the implementation of the system, starting with the board of directors, staff that has the responsibility and must set the policies and establish incentives for its fulfillment. The direction of the human resource and in general all the managing team must be committed using by all the tools for motivation.

Each company must study its particular case and implement its own model, with the resources available to them, in clearly understandable terms by all the people of the organization, who must commit themselves voluntarily to their compliance.

In a certain way, we can say that half of the work consists properly of the planning of this. For this, it will be followed, in general terms, by the steps that later are described. The other half consists of the opportune control of the results; this is, the monthly accomplishment of the production charts and sales, and others that are due to be elaborated by responsibility centers, that is to say:

- Budget of production with its relatives by marriage
- Budget of materials, (differentiating raw materials concerned nationals)
- Budget of purchases
- Budget of manual labor
- Budget of general expenses of manufacture
- Budgets of administration expenses
- Budget of sales and trade expenses
- Budget of publicity
- Budget investments in human resources
- Budget of other investments
- Budget of payment of taxes
- Budget of cash
- Budget of financial expenses (based on the cash projection)

The careful and analytical comparison of the causes by which the results were not fulfilled, and the feedback of the system, will be the base to obtain most budgetary age, that, is obtained the day that the company is in conditions for projecting basic financial statements: General balance sheet, Earnings statement, State of Sources and Applications of funds and the financial indicators par excellence: The Projection of the Flow of funds and the EVACp.

When a company manages to take that step, is in conditions for planning its development according to the policy drawn up by its directors within the frame of the main target to generate value with direct profit for the people who interact in tangible ways and for the owners, including the small shareholders through the increase of the value of the shares in the market.

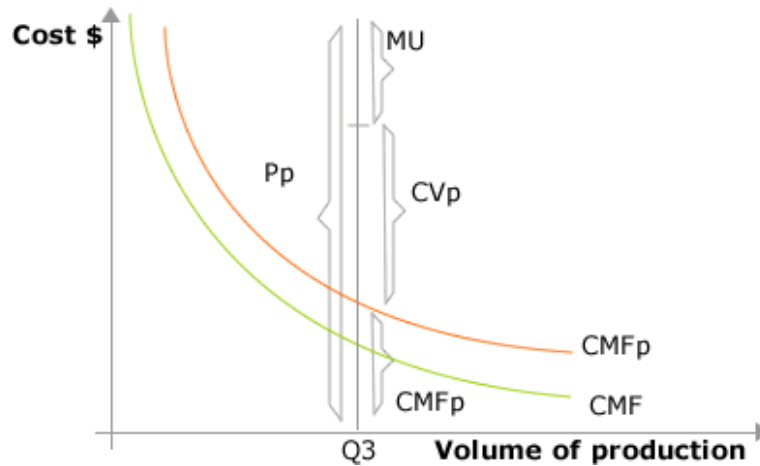
If we thought about planning of profits, we needed a system of costs that allows for a clear differentiation between the fixed costs and the variables, that is to say, those that depend on the volume of production; of a reviewed analysis of equilibrium point to calculate the minimum amount to produce and to sell, an wide knowledge of the market to calculate the potential of sales and, the cost of capital to the company.

## 1. BASIC CONDITIONS

**A. PROJECTION OF SALES INDEPENDENTLY TO THE PRODUCTION CAPACITY:** Using econometric models like the matrix of sectorial growth, regression analysis, analyses of correlation, movable averages, etc.,

combined with quantitative models as one acquires knowledge in **HELUSA S.A.**

**B. A GOOD SYSTEM OF COSTS THAT ALLOWS ITS PROJECTION:** We must begin by considering, with the aid of the experts, the possible increase in different items which conform the cost of products. This way, we can elaborate the curve of the projected fixed average cost, to observe its behavior at different levels of production.



$$Pp = CMFp + CVp + MU$$

**Pp:** Price to a Q3 amount

**CMFp:** Projected fixed average cost

**CVp:** Projected variable cost

**MU:** Margin of profits

**C. CALCULATION OF THE COST OF THE CAPITAL:** As we analyzed in a previous document, one calculates base on the weighted average of the different alternatives of financing. It is a dynamic concept that varies as changes with the financial structure appear. For the plan of value generation one is due to work with the costs projected according to the plan of anticipated financing, looking for an optimal financial structure.

**D. ANALYSIS OF THE POINT OF REVIEWED BALANCE**

**E. ESTIMATION OF THE CAPACITY OF INDEPENDENT PRODUCTION FROM THE CAPACITY OF SALES:**

The areas of sales and production in simultaneous form elaborate the respective budgets with the use of all the

techniques available to them. The people in charge of their compliance, when putting it under their approval, must sustain them with clear and forceful reasons that they allow the direction to trust them and to respond to all types of questions before its approval.

In this first attempt, the production is due to budget with the resources available then, but obvious, looking for its optimization. The sales must be budgeted without extraordinary investments of any nature, that is to say, delivering the maximum attack normal to take care of the market.

**F. COMPARISON AND ANALYSIS OF THE PREVIOUS RESULTS:** Initially we will make a comparison for all the periods in general; the annual number of sales versus the number of production. If the amount to sell is superior to the amount to produce, we must go into studying and quantifying the possible alternatives to increase the production to the required level, for example:

- To buy two machines of such specifications. They must be in operation from so dates and require an investment of so many pesos or dollars (monetary units).
- In the opposite case, the alternatives will study to increase the sales (businesses of export, reduction of prices, bargains, special plans of trade etc.). If any possibility does not look feasible, it goes to the search of mechanisms to reduce the production, quantifying all the possible alternatives:
  - Reduction of staff
  - Change of product mixture
  - Cuts of the installed capacity, etc.

**G. CALCULATION OF THE TOTAL COST OF PRODUCTION AT THE CONSIDERED LEVEL:** After this comparison, we go to the curve of the projected fixed average costs and calculated as it is going to be its value for the predicted volume of production (Q3), which is equivalent to the average sum of the fixed one (CMF3) plus the variable cost (V3) unitary with values considered according to what was indicated in step 1.

**H. ESTIMATION OF INCREASE IN PRICES:** With this fixed cost plus the addition of the variable cost and the margin of profits, we considered the projected unitary price for the amount (Q3). Comparing the previous one with the effective sale price, we calculated the increase that is required to conserve the profits margin,  $P_p/P_a =$   
%

$$Pp = CMF3 + V3 + Up3$$

**Pa:** Considered sale price

**CMF3:** Fixed average cost at a level of production 3

**V3:** Variable cost

**U3:** Awaited Margin of profits

**I. LATER ESTIMATIONS OF SALES AND PRODUCTION:** If in regard to the projection of the increase of prices in the national scope (projected index of inflation) the resulting increase is out of proportion, again the budgets of production and sales are used, logically looking for, the possibility of increasing the amounts (studying the different tools from creation of demand and increases of short term productivity), in order to situate us in a feasible level, that is to say, that the increase in the sale price is inferior or in extreme case, equal, to the projected index of inflation.

It is required to study alternatives until situating to us in a reasonable increase of prices, according to the conditions of the market. Letter is due to take notices of the investments that require the studied alternatives get to this situation, because they reject in the flow of funds, which serves as base for the calculation of the cost of capital and the financial expenses.

**J. INITIAL APPROVAL OF BUDGET (FIRST ANALYSIS):** The resulting budgets of production and sales must yet be purified and analyzed at the highest level and the possible detail for their final approval. Also the other elaborated budgets, which will be sustained by the people in charge of their enforcing and properly approved by the top management, using the appropriate indicators and comparing with the previous periods.

Once approved these budgets it is come to determine the games that are required to be able to arrive at them, like the budgets of: Materials, Indirect Manual labor, Expenses of Manufacture, Maintenance, Sales Expenses, Appropriations for Publicity, research and Development, Preservation of the environment, Qualification of the staff, Expenses for Trips, Taxes and the others depending on the company individually.

**K. INITIAL PROJECTION OF THE EARNINGS STATEMENT:** With the budgets approved in the first analysis we were in the condition for structuring a projection of the operative result, bases to continue with the elaboration of the general plan.

<b>Sales (Prices Projected Pp)</b>	XXXXXXXXXX	V
<b>- CMV</b>	(XXXXXXXXXX)	CMV
<b>Rough profit</b>	XXXXXXXXXX	UB
<b>- Administration Expenses</b>	(XXX)	GA
<b>- Sale Expenses</b>	(XXX)	GV
<b>Operating profit (Losses)</b>	XXX	UO

The operating figure of calculated profit requires special attention because it constitutes the first filter.

It is initiated calculating the indicators that permit evaluations to know:

a. 
$$\frac{\text{Operating profit}}{\text{Net sales}}$$

b. 
$$\frac{\text{Administration Expenses}}{\text{Net sales}} = \%$$

c. 
$$\frac{\text{Sales Expenses}}{\text{Net sales}} = \%$$

d. % of increment in the rough profit with relation to the previous periods.

e. 
$$\frac{\text{Patrimony Increment \%}}{\text{Active Increment \%}} = \%$$

If the predicted figure of operating profit fully satisfies, comparing with the indicators of the industry is passed to split the plan in periods of control, by centers of responsibility. Thus the base for the projection of funds is prepared.

#### L. DISORDER OF THE OPERATING PLAN BY CENTERS OF RESPONSIBILITY AND BY PERÍODIC

**FIGURE (monthly, weekly, annual):** The incomes by different concepts of the elements of the cost, and the expenses projected split in budgets by centers of responsibility according to the letters of organization of the company, of such way that they have always a responsible person for its compliance, setting down the bases for the control of the plan and the taking of corrective actions.

**M. ESTIMATION OF THE FINANCIAL EXPENSES:** The financial budget of expenses depends on the financial structure that the firm adopt and of the projection of the flow of funds, in the measurement that the approach to the execution of it forecasts. The most important step consists of structure; is what commonly we call the prognostics of incomes and expenses, prepared based on the disorder of the annual budgets priory approved in monthly figures and keeping in mind the stationality of the sales and the collections, of such a way that structuring it to a follow-up.

For this, we should keep in mind the existence of expenses that do not imply exit of cash, as the depreciations, the amortizations, some social fees, etc. The budget of expenses comes from the expenses that require exit of cash, in deadlines of rigorous fulfillment, therefore for a company is very important the history of honoring its obligations. Any additional expense that presents itself should be authorized priory and tied to the general projection.

The incomes result of the budgets of sale, in the deadline granted by the company, except the estimation of the delays of clients plus the recovery estimated of the accounts receivable defeated. Any income should be added that can be predicted at the moment of the calculation.

Comparing the incomes and the expenses, can present two basic situations:

1. Balancing figures at the end of the year with a foreseen deficit.
2. That it be finished with surplus, thus in some months itself present deficit of treasury.

If we start from the assumption that all the current actives should become money in a lower cycle to a year, normally the current income should be enough to cover the current expenses and, therefore, it is to the second situation be expected. This means that if the surplus of budgeted cash for the end of the exercise turns out to be normal, scored with a good criterion, the situation is clear and we will proceed to finance the possible temporary deficit with short term loans. We should adapt to the conditions of the money market.

In Colombia for example, the finance companies usually lend to for a year with payment of quarterly interests anticipated and guarantees to capital also quarterly. We would request the amount required plus the necessary interests to cover the initial payment.

If the projection of cash shows a surplus month by month and if the accumulation presents considerable amount, it is probable that the company has an over investment in current active, which implies that we are losing profit value in the exercise. In this case, we can think about studying new investments or in an enlargement of the plant.

If on the other hand, a permanent deficit is presented, it implies there is a need of capitalization according to the size of its accumulation through the year. In this case, it is very important to study the possible causes of the situation and how to solve them. Among others there could be:

- a. Violation in previous periods or in the exercise in question, of the principle of conformity according to which, the fixed assets and the fixed part of the current active should be financed with its own capital and with long passive term.
- b. It lowers profit value, which to the faster the operating cycle, it reflect it self in less liquidity.
- c. Over investment in fixed assets, or in other assets that are not generating funds, thus they are themselves acquiring more value.

Once the problem is detected it should be decided which alternative of financing well be through execution of assets, retention of utilities or capitalization of the associates and then proceeds to elaborate a new flow of funds that satisfies normalizing fully the situation.

This, adjusted with the initial figure of cash, equivalent to the final balance of the previous exercise, will serve as a base to calculate the financial expenses added to the ones that brought the previous flow, the expenses incurred by the temporary deficit and reducing the income by the performance that can be obtained when there is a present surplus of cash.

By the way, upon presenting the solution of financing in itself we cannot lose sight of the tributary aspect, which does that in principle, the debt result as the cheapest alternative of financing. The undue use of this concept has carried many businessmen to deep financial problems that end in technical bankruptcy. Logically, the capitalization will be subjected to an improvement of the net figure of profit and the value generation index corrected and projected, EVACp.

**N. DEFINITION OF THE GOAL OF PROFITS:** Taking the patrimony of the firm, without losing sight of the general conditions of the market and in realistic terms, the goal of profit value should be set so that the owners or directors consider it reasonable. For it this we will use:

- Rough Index profits / net Sales: Serves as a parameter to calculate the efficiency of the operation, base to think about alternatives of financing
- Net profit / net Sales
- Net profit / Patrimony
- Net profit projected / net profit of the exercise base(%)

- Comparisons with indicators of the industry
- Financial structure, which should contribute to that goal in the measurement that should be optimum

For this we simulate projections of the State of Results, with increments of prices that are not over the increase expected for inflation according to the macroeconomic estimations. Of the amount of cash resultant we do the appropriations that define to the Board of directors for research and Development, Training and human growth, positioning and preservation of the environment.

**O. TO PREPARE THE STATE OF RESULTS:** With all the resultant information of the calculations, we are ready to prepare a state projected of results oriented to the generation of value (useful for administrative effects), we observed that all the components of the cost and the appropriations of expenses are presented in double appropriations, an indicating the projected figure and another free to place the resultant value in the implementations. In this way, the control of the Plan is prepared indicating the unfavorable and favorable variations and its effects in the end result. With each one parted a complementary periodic fee that should be indicated, the cause of the inconsistency and the corrective action to take.

## SAVERE INC

### STATE OF RESULTS PROJECTED

NET SALES

- PREDICTED VARIABLE COSTS :

Raw materials

Labor

+ Sobrecostos by inefficiency:

Raw materials

Labor

VARIABLE PRIME MARGIN

- EXPENSES PROJECTED OF ADMINISTRATION VARIABLES

+ Variable Administration Expenses Excess (Reduces the margin)

- EXCESS PROJECTED OF VARIABLE SALES

+ Over expenses of Variable Sales (Reduces the margin)

PREDICTED MARGIN OF CONTRIBUTION

REAL MARGIN OF CONTRIBUTION

FIXED EXPENSES:

- Of Production projected
- + Production Expenses Excess
- Of Administration projected
- + Administration Expenses Excess
- Expenses of Sales
- + Sales Expenses Excess

OPERATING PROJECTED PROFITS

REAL OPERATING PROFITS

- FINANCIAL EXPENSES PROJECTED

- + Financial Excess of Expenses

PROFITS BEFORE TAXES

- IMPOSED PROJECTED

- + o - Results in Payments of Taxes

NET PROFITS PROJECTED

REAL NET PROFITS

+ EXPENSES CAPITALIZER:

- Research and Development
- Preservation of the environment
- Positioning
- Human development

PROFITS CORRECTED AND PROJECTED FOR THE EVA (EVACp)

It requires special attention because is oriented to the implementation of the salaries of risk.

TIMELY the periodic report should be presented oriented to the calculation of the EVACp, it should elaborate a matrix as it is indicated subsequently, since it permits a clear orientation toward the control of all the activities predicted in the initial plan, indicating the leaks that are presented with the pertinent notes that they serve as a guide to take corrective actions.

## PLAN VALUE GENERATION

### SAVERE INC

Date: \_\_\_\_\_ Period of evaluation (month, week, day): \_\_\_\_\_

Center of Responsibility	Concept	Projected Value	Final Value	Notes (Explanation of the variation)	Person in charge (Position)
Production: Troqueladoras	Cost of M. L.	2'000.000.00	2'300.000.00	Payments of not budgeted extra hours due to an unexpected increase in the production due to the increase of units from the buyer	Andrés Ortiz (Head of Troqueles)

Elaborated: \_\_\_\_\_

Analyzed by: \_\_\_\_\_

Section: \_\_\_\_\_

Section: \_\_\_\_\_

**P. CALCULATION OF THE EVACp:** With all the previous information we are ready to calculate if the plan predicted allows to generate value or if on the contrary it destroys, it in which case a total replanning would be required.

We remember the formula of the **EVACp** (Savere):

$$EVACp = \frac{U + Id + Pu + Cp + O}{P + A} - CC$$

**EVACp:** EVA corrected and projected

**U:** Profit of the period

**Id:** Investments in research and development

**Pu:** Investments in publicity capitalized

**Cp:** Training

**O:** Other investments capitalized properly borne

**CC:** Cost of capital

**P:** Patrimony

**A:** Revaluing of the patrimony

It is probable that after preparing the financial budget of expenses it messes up the figure of expected profit. If the alternative is selected well the amount of net benefit should be improve with relation to the initial situation.

Also it can be presented the contrary case by difficulties to obtain adequate financing.

In case one or the other present, we will proceed to perform the pertinent adjustments or to replant the situation again until we summarize the plan that will serve as guide of action for the business. In practice many adjustments are required to achieve a definite the optimum proposal, that is the one that should generate value.

If the EVACp fully satisfies, we concentrate in the projections that permit to refine the plan, as follows:

#### **Q. DISORDER OF THE ANNUAL PROJECTION IN PERIODS (Semester, Quarterly, Monthly, Weekly or**

**Daily):** The degree of disorder depends on the level of control and the periodicity with which we wish to exercise it in the general direction. To different administrative levels, the control will exercise different forms, for example, for the presidency is very important the EVACp, while for the supervisor of production raw materials the consumption per unit, of raw materials is more important.

#### **R. GENERAL PROJECTION OF THE BASIC FINANCIAL STATES**

- a. **General Balance:** It is taken as a base for the balance of the previous exercise, the state of results projected and the probable changes motivated by the predicted actions. For example: If the plan contemplates a capitalization, the patrimony in the corresponding appropriation will be increased.
- b. **State of Results Projected.**
- c. **Projection of the Flow of Funds (financial indicator par excellence).**
- d. **EFAFP (Savere) State Projected of changes in the financial situation:** It is prepared following the steps indicated in the document on the subject.
- e. **Financial Indicators:** They should be calculated by liquidity indexes, activity, indebtedness, cover and profit value. Based on them is the benchmarking prepared or by comparison with the indicators of the leading companies of the world in the corresponding sector.

**S. GENERAL DISCLOSURE:** Once approved the plan to the highest level, it should gather the responsible for its enforcement for its final disclosure and to achieve the contest of all involved in order to obtain the objective. The budgets finally approved should acquire the character of "compromise" well understood in administrative terms and they will serve as a base to do periodic evaluations and the making of decisions that permit to timely correct the lacks that should appear.

The objective figure serves to set some parameters that permit to organize a plan of participation in the profits, which well structured can become an excellent tool the increase of productivity, defense against inflation; social element of justice and of generation of value, the only reason that attracts investors especially the foreigners who use the EVA as its indicator par excellence, taking advantage of the electronic banking and the internet.

The periodic comparison of the real results with them projected they will serve of base to take corrective actions that permit to perfect the system and to achieve the objectives.

To properly orient investors it is required to create a culture of financial projections that ease the comparison with the opportunities that the market offers. The comparison of the real results projected to the end of the exercise will permit to structure the indicators of credibility that will serve as a guide to orient investors.

**T. CONTROL:** It constitutes an objective base to evaluate the fulfillment or to detect mistakes in the elaboration of the general plan.

It should be prepared with the periodicity that the characteristics of the business as individually require as follows:

- a.** It should be opportune, being accepted the sacrifice of the precision or accuracy for the sake of the promptness so that it permit the analysis and takes the corrective actions.
- b.** Clear and concise objectively informing the facts that could affect the result. It is important to request the explanation concerning the director of the center of responsibility before supplying information at the upper level. They should be signed by whomever elaborates the report and by the person responsible for the respective center.
- c.** The executive responsible should participate in presenting alternatives to improve the situation with a focus oriented to see the making of decisions. ■