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What if...? Contingency financial planning vital

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Well-written business plans and their underlying financial plans define clear goals and the success criteria by which the outcome will be measured. But too often these plans don't define criteria for failure. Without that, how do you answer the questions: What if you're wrong? How will you know? What will you do about it?

An optimistic focus on achieving goals must be balanced with a hard look at all of the things that might not go according to plan. What if you discover midyear that your initial assumptions were wrong but you're not ready to adjust? It might give you some comfort knowing the license plate of the truck after it hits you crossing the street, but unless you break the pattern of just looking in one direction instead of both, you will never reduce the chance of getting hit in the first place.

From the start, high-growth technology companies should run "what if" scenarios that challenge the assumptions on which their plans were built. The effects of changing each assumption should be analyzed and contingency plans developed. This way you set the criteria for success and failure.

"What if" planning is not complicated, it just requires the right tools and time commitment.

Consider a "what if" scenario related to costs. Assume your financial plan includes borrowing \$10 million at a variable interest rate of prime plus .5 percent. You calculate net profit of 6 percent, assuming interest rates rise modestly (plus 1 percent) over the next two years.

What if you're wrong? With good "what if" planning tools, you'll be prepared, having run in advance various interest-rate scenarios that tell you exactly how higher or lower rates affect your gross and net profit.

But don't forget to look in several directions for that truck. The real danger for a growing business is not just net margin -- it's also cash flow. Solid "what if" planning also shows how ballooning payments affect your monthly cash flow. If your planning spreadsheet can't show you this, you might find yourself not only running on slimmer margins, but scrambling to make payroll as well.

Now consider a "what if" scenario related to revenue. The revenue projection in your business plan assumes you will close 10 percent of the leads you generate. Your cost per lead is estimated at \$100, so marketing expenses are \$1,000 per sale. You project that sales will close within three months at an average sale price of \$25,000 billed Net 30. You plug these and your other cost assumptions into your spreadsheet to arrive at a net profit of 6 percent.

Nine months later, you have no cash to make payroll, and you scramble to figure out what went wrong. It turns out your sales cycle was actually six months, your cost per lead was \$500, your conversion rate was 5 percent, and your average sale price was \$15,000.

Maybe you couldn't have foreseen this, but still you could have planned for it.

If you had tested your assumptions against a variety of "what if" scenarios, you could have adapted your plan when two or three months' worth of real data showed that your lead cost, close rate and average sale price were way off. You could have reacted before your working capital was exhausted.

Potential flies in the ointment are endless. Midyear, the health insurance companies might increase their corporate rates. Competitors might start a price war, forcing you to discount prices. Or things could go right: Your sales could skyrocket, requiring increases in customer support and tech support staffing and related overhead.

Effective "what-if" planning requires tracking financial data such as average sale price along with non-financial data like lead close rate; and projecting cash flow based on an assumption of days sales outstanding -- tasks not easily accomplished in spreadsheets. However, there are good software tools available that integrate with your accounting applications and easily generate "what if" scenarios.

No matter how you do it, the first step is to look both ways, putting forth both success and failure criteria, and challenging your own business plan assumptions from the beginning. This will help you adjust your path across the street if needed, and get you safely to the other side.

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