**TRAINING IN FINANCIAL AND BUSINESS MANAGEMENT FOR ROAD CONTRACTORS**

**MODULE TWO: SESSION FIVE: PARTICIPANTS’ NOTES**

**LONG TERM BUSINESS PLANNING**

1. **Objectives**

By the end of the session participants will be able to:

1. To make long term financial performance projections;
2. To make long term cash flow projections;
3. To differentiate between long term profits and cash flow based on the projections made;
4. To analyze the generated projections and make appropriate adjustments to improve results.
5. **Purpose for long term planning**

Long-term business planning is done in recognition of the fact that reaching some of the construction firms’ goals requires an effort to be undertaken over a number of years, with many steps that must be completed along the way. In contrast, the company’s annual plan is focused on how to allocate the company’s financial and human resources only for the next year. The annual plan has much more detailed financial projections than the long-term plan. The long term (five year) financial plan will summarize the content of the strategic business plan.

1. **Long term plan development process**
2. Define what long-term means for the company. Generally road construction firms may require a cycle of at least five years. Most road contractors cover a longer period because of the complex and heavy investment and the long term nature of road construction contracts. Gravel roads may be done within a year. But even then the process from bidding, design and implementation may span over two years or more. Therefore choose a time frame that represents the time required to take your company to the next level of success. It may be more than five years.
3. Gather relevant data relating to trends in the construction industry or trends in other supporting industries such as material suppliers and transporters with whom a long term partnership may become necessary. Make it an ongoing process. Develop a system for uncovering new opportunities. Then develop a long-term vision. Look five years into the future and create a picture of how you would like to see the company develop. A vision of revenue growth, work force, product range (gravel, tarmac, designs, bridges…), geographic coverage…etc.
4. Create long-term objectives and plans. Attach a cost on each planning option and project. Set specific objectives such as revenue in the next five years from now, length and type of roads to be done. The objectives don’t need to be numerous. The business should focus on about five objectives at any one time. Think of them as strategic pillars for your company’s long-term future. Objectives should address identified weaknesses and threats and also seek to take advantage of identified opportunities and strengths.
5. Select the long-term opportunities on which to concentrate based on your data gathered and your long-term vision. Reflect on new road construction, long term opportunities available nationally and locally.
6. Where there are several contracts running, create activity plans for each of the projects. Determine, in a broad sense, what needs to be accomplished each year on each of the projects over the time horizon.
7. Review and revise the long-term plan each year as the business environment changes. Opportunities may emerge that are potentially more profitable than the ones you selected to pursue in the previous year’s long-term plan.

The real value of long term planning is not in the plan itself, which will need to be changed, **but in the process of planning, thinking ahead and considering the potential impact of outside influences on your business.** While nothing is certain, knowing at least where to take your business for it to be successful is a good start in the right direction. A business plan can help ideas on road construction services become successful through focused planning and forethought.

1. **Format and analysis of long term income statement**

The format of the long term income statement is the same as that for the short term except that this is on annual basis. The annual cash flow is the summary of the 12 months income statements. While the short term one indicates the performance and trend during the year, the long term one shows the performance and trend over the period of five or so years.

Analyze the revenue on an annual basis to ensure that it meets the targets set over the planning period in terms of turnover and profitability. The most challenging issue in preparation of long term statements is the quality of the assumptions in predicting the future occurrences.

1. **Format and analysis of long term cash flow statement**

The format of long term cash flow projection is the same as the one for the short term except that the long term one is annual while the other was monthly. The long term annual cash flow is the summary of the 12 months cash flow. Study the trend of the five year cash flow balances to make decisions about the capital needs of the business, the timing and possibility of withdrawal from the business or that of investing in assets, working capital and other items. Where large cash balances are building up, the business will recognize it and plan to invest it in good time.

1. **Group activity (all groups)**
2. Using assumptions in Munaku case study develop a performance forecast for five years.(Munaku case Appendix V)
3. Make a five- year cash flow projection.
4. Note any emerging trends in cash flow and profits.
5. Propose strategies that may be undertaken by Munaku to improve both profitability and cash flow. Relate the strategies to your company.
6. **Munaku Contractors long term income projections**

|  |  |  |
| --- | --- | --- |
|  |  | **Munaku income and expenditure Projections**  |
| Year |  | 1 | 2 | 3 | 4 | 5 | Total |
| Road work done in Kms | 0 | 24 | 24 | 24 | 24 | 24 | 120 |
| Price offered | Munaku |  450,000  |  450,000  |  450,000  |  450,000  |  450,000  |  2,250,000  |
| Revenue  |  |  10,800,000  |  10,800,000  |  10,800,000  |  10,800,000  |  10,800,000  |  54,000,000  |
| Direct costs: |  |  |  |  |  |  |  |
| Material | 8,000 tonnesx20000 plus vat at 20% |  4,608,000  |  4,608,000  |  4,608,000  |  4,608,000  |  4,608,000  |  23,040,000  |
| Direct labour | 60m/kms |  1,440,000  |  1,440,000  |  1,440,000  |  1,440,000  |  1,440,000  |  7,200,000  |
| Machine hire | 12m/kms |  288,000  |  288,000  |  288,000  |  288,000  |  288,000  |  1,440,000  |
| Fuel | 9000ltsx3500 |  756,000  |  756,000  |  756,000  |  756,000  |  756,000  |  3,780,000  |
| Overheads | 100m/kms |  2,400,000  |  2,400,000  |  2,400,000  |  2,400,000  |  2,400,000  |  12,000,000  |
| Management salaries | 15m/month |  180,000  |  180,000  |  180,000  |  180,000  |  180,000  |  900,000  |
| Depreciation | 2,437,500 per kms |  58,500  |  58,500  |  58,500  |  58,500  |  58,500  |  292,500  |
| Amortization | 1,250,000 per kms (for 3 years) |  30,000  |  30,000  |  30,000  |  -  |  -  |  90,000  |
| Interest |  |  130,800  |  92,400  |  54,000  |  17,400  | 0 |  294,600  |
| **Total cost** |  |  9,891,300  |  9,852,900  |  9,814,500  |  9,747,900  |  9,730,500  |  49,037,100  |
|  |  |  |  |  |  -  |  -  |  -  |
| **Net profit** |  |  908,700  |  947,100  |  985,500  |  1,052,100  |  1,069,500  |  4,962,900  |
| Provision for taxation 30% |  |  272,610  |  284,130  |  295,650  |  315,630  |  320,850  |  1,488,870  |
| **Profit after Taxation** |  |  **636,090**  |  **662,970**  |  **689,850**  |  **736,470**  |  **748,650**  |  **3,474,030**  |
|  |  |  |  |  |  |  |  |

1. Munaku Contractors long term cash flow projections

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Year** | **Narrative** | **1** | **2** | **3** | **4** | **5** | **Total** |
| Road work done in Kms | 0 | 24 | 24 | 24 | 24 | 24 | 120 |
| Price per km |  |  450,000  |  450,000  |  450,000  |  450,000  |  450,000  |  |
| Revenue receipts |  |  9,000,000  |  10,800,000  |  10,800,000  |  10,800,000  |  10,800,000  |  52,200,000  |
| Share capital |  |  -  |  |  |  |  |  -  |
| Loan Capital |  |  -  |  |  |  |  |  -  |
| Total receipts |  |  9,000,000  |  10,800,000  |  10,800,000  |  10,800,000  |  10,800,000  |  52,200,000  |
| Payments |  |  |  |  |  |  |  |
| Additional land 5 acres |  |  500,000  |  |  |  |  |  500,000  |
| Building and equipment |  |  520,000  |  |  |  |  |  520,000  |
| Startup capital |  |  90,000  |  |  |  |  |  90,000  |
| Material | 8,000 tonnesx20000 plus vat at 20% |  4,608,000  |  4,608,000  |  4,608,000  |  4,608,000  |  4,608,000  |  23,040,000  |
| Direct labour | 60m/kms |  1,440,000  |  1,440,000  |  1,440,000  |  1,440,000  |  1,440,000  |  7,200,000  |
| Machine hire | 12m/kms |  288,000  |  288,000  |  288,000  |  288,000  |  288,000  |  1,440,000  |
| Fuel | 9000ltsx3500 |  756,000  |  756,000  |  756,000  |  756,000  |  756,000  |  3,780,000  |
| Overheads | 100m/kms |  2,400,000  |  2,400,000  |  2,400,000  |  2,400,000  |  2,400,000  |  12,000,000  |
| Management salaries | 15m/month |  90,000  |  90,000  |  90,000  |  90,000  |  90,000  |  450,000  |
| Owners dividends/drawings | 10m/month |  120,000  |  120,000  |  120,000  |  120,000  |  120,000  |  600,000  |
| Depreciation | 2,437,500 per kms |  -  |  -  |  -  |  -  |  -  |  -  |
| Amortization | 1,250,000 per kms for 3 years |  -  |  -  |  -  |  -  |  -  |  -  |
| Loan repayment(including interest) |  |  322,800  |  284,400  |  246,000  |  191,400  |  -  |  1,044,600  |
| Taxation |  |  -  |  272,610  |  284,130  |  295,650  |  315,630  |  1,168,020  |
| **Total payments** |  |  11,134,800  |  10,259,010  |  10,232,130  |  10,189,050  |  10,017,630  |  51,832,620  |
|  |  |  |  |  |  |  |  -  |
| **Net cash**  |  |  (2,134,800) |  540,990  |  567,870  |  610,950  |  782,370  |  367,380  |
| Opening balance | -999,000 |  (999,000) |  (3,133,800) |  (2,592,810) |  (2,024,940) |  (1,413,990) |  (999,000) |
| **Closing balance** |  |  **(3,133,800)** |  **(2,592,810)** |  **(2,024,940)** |  **(1,413,990)** |  **(631,620)** |  **(631,620)** |
|  |  |  |  |  |  |  |  |

1. **Suggestions to improve profitability:**

Given the cost structure for Munaku, Direct costs are 66% of revenue while overheads are 26% of revenue both totaling 92%. Munaku is earning a margin of only 8% on revenue generated. We know that the price per Kms of road cannot exceed shs 450 million. The return on capital for Munaku is also low at 8.6% in the first year reducing to 7.4% in the fifth year. The capital structure is dominantly equity 9:1 at the beginning and 10:0 in the fifth year. In order to increase profitability therefore, Munaku must do three things. First, reduce costs both direct and overheads to increase his margin on revenue from the current 8% to about say 20%. Second, he should gear up his business to about 2:1 equity debt ratio. If he is to introduce any new capital in the business it should be through borrowing. That will boost up his return on equity. Thirdly, Munaku could reduce on the idle assets he has such as land and use the money to do more road mileage thereby increasing his revenue.

1. **Suggestions to improve cash flow:**

In order to improve the cash flow Munaku could consider the following:

1. Defer the purchase of land of shs 500 million as he already has a big chunk of it that cost shs 1,500 million. He could even consider disposing it off and then inject the money in capacity to do more road works.
2. Convert the overdraft of shs 999 million into a term loan. This will enable him to repay it over a period of time and also boost his gearing.
3. Obtain a lease to acquire the machinery
4. Defer to build or obtain a term loan to finance the buildings.
5. Arrange for credit terms for fuel and materials instead of buying them on cash.