SPICE ROUTE
FINANCE

# A Definitive Guide on Accounting & Finance for Startups

**The intent of this e- Book is to let entrepreneurs, startups and small businesses understand everything about finance.**

Starting with an introduction to bookkeeping and accounting concepts, we explain what a business plan is and why it is important. Additionally, we delve into business models, highlighting their distinctions from other business plans. We cover the business model canvas with an example, and finally, we explore Financial Planning and Analysis — elucidating what it means and how it contributes to the success of your business.

*Do you know, not having a strong finance team is like flying an airplane with no windows and no navigation system –you are in the air but not knowing exactly where you're going. And this applies to companies at any stage in their life cycle.*

## I. Lets get the basics right!

Financial management for startups is, without a shadow of a doubt, the key to any start-up's success. There are going to be myriad things to manage and keep track of, and it can become quite overwhelming without a solid plan in place. You've got the idea, developed a business plan, and jumped into building your very own business from the ground up. However, there can be several pitfalls that new business owners fall into when it comes to the financial structure and maintenance of the start-up.

*To push past short-term survival and into a thriving, profitable company, what steps do you need to take to be prosperous?*

### A) Set up a business bank account

First things first, stop using your personal account for business transactions. It might sound simple, but this can become a real issue. Complications can arise if personal and business ins and outs are not kept separate, especially when it comes to tax time. It would become apparent incredibly quickly that things could be missed.

If nothing else, keeping them separate allows you to maintain complete control of your finances, which, in the long run, will make your life easier.

### B) Manage cash flow

This is fundamental, not just during the startup period but throughout your entire lifetime as a business owner and entrepreneur. So much of financial management for startups involves knowing where your cash is coming from and when it will arrive.

Starting off, it's important to negotiate good terms with your suppliers and stick to those terms. There's no need to pay early—pay for invoices when they're due and preserve cash flow. On the other side of the coin, when it comes to sending out invoices, make sure they are done in a timely fashion—pretty much as soon as possible after the work has been done.

Ensure that when you invoice, you undertake good credit control procedures. Be on the ball with getting the money and getting people to settle their side of the agreement on time. It's simple- without money coming in, there's no money to go to suppliers.

### C) Limit your fixed expenses in the beginning.

In the beginning stages of a startup, keeping your expenses low is the key to longevity. You don't need a huge, elaborate office in the heart of your city or fully catered meals three times a day.

Operate so that you can allocate the majority of your capital to growth, which will enable you to one day implement any perk you want. Too many startups focus on the wrong things, like fancy offices and over-the-top amenities, and forget that generating revenue should be their primary focus.

### D) Build strong relationships

A strong network goes a long way when you launch your startup and beyond. Develop relationships with suppliers, clients, and even your trusty accountant if you have one. These are the people who will keep your business afloat. Without them—and the customers, of course—your bright idea will fall flat. While you might want to go at it alone, be sure to keep the right people sweet and ask for advice when you need it.

### E) Keep good records

There are going to be invoices, receipts, and all kinds of paperwork and finances to keep track of. Make sure you have a system in place to ensure that nothing gets lost amongst the chaos. Keeping good records is vital to the ongoing health and viability of financial management for startups—keep hold of everything. Also, make sure you claim everything you can during tax season. To do that accurately, you'll need to keep note of every little detail and outgoing that can be reclaimed. For example, ensure that you log miles and claim them back from the business, as well as keeping hold of receipts for anything you buy for the firm.

### F) Get an accountant

Keeping on top of everything involved with financial management for startups will be hard work for any fledgling startup—especially if number-crunching isn't your strong suit.

While there are several tools out there that can help you track cash flow, send automated invoice reminders, and organize records, it's still smart to speak to an accountant and/or a bank manager. Handling everything alone might be smooth in the early days, but things will become increasingly complicated, and it's a good idea to have someone who understands the ins and outs of business finance to guide you through it. They can help you plan and budget for the year, as well as work out where changes need to occur to boost profits. So be sure to ask for the help and advice you need early on and before an issue arises.

## II. Check how ready you are

In the beginning stages of managing your startup, the nitty-gritty of finances might be the last thing you want to think about, but letting financial planning fall by the wayside is a troubling habit for new business owners.

The pressures of success and profitability can weigh down a new business. Regardless of your familiarity with business finances, there are key questions and resources to keep in mind. Here are four areas to incorporate into the management of your start-up's financial health.

### A) Recognize your financial literacy

Gathering the proper tools and educational resources to understand and manage your business's finances takes time, but it'll save you a lot of stress and money. Don't be afraid to admit when you don't understand something.

### B) Determine your start-up's financial and market logistics.

Once you have a working knowledge of what's what in business finances, you have to ask the tough questions specific to your enterprise:

- How much money do I need to start this business?
- How long until my product or service becomes profitable?

There is no one perfect answer to these questions. It depends entirely upon your niche, which should be as narrow as possible in the beginning.

Understanding your niche will help answer these more concrete questions. Service businesses, for example, will take much less money to start than product businesses, which will accrue more expenses.

*No matter your market, the key is to not overspend.*

### C) Conduct financial forecasting to gauge profitability

Much like determining how much money you'll need to start a business, your future profitability depends on many different factors.

Most small business owners need to achieve profitability in the first year to have a sustainable business. If you take the time to perform financial forecasting—a management tool that estimates profitability based on past, current, and present financial conditions—then you should know ahead of time when you're supposed to be cash-positive.

### D) Establish financial goals

Rather than just saying, "I want to build a multi-million dollar company," you need to break financial goals down into reachable and measurable ones.

Setting monthly, weekly, or even daily revenue goals allows you to stay on track and make the necessary adjustments for constant growth. You can also set milestones to achieve along the way, providing you with smaller goals to consistently hit. Knocking out these little goals can give you the confidence needed to keep powering through the entrepreneurial journey.

## III. Finance Function Pyramid


**Finance Operations:** This forms the base and will include activities like accounting, transaction processing, financial reporting.
**Financial Planning & Analysis:** This layer involves activities budgeting, forecasting, variance analysis.
**Strategic Financial Management:** This layer focus on long-term planning, capital structure decisions, mergers and acquisitions, and overall financial strategy.

**Executive Decision Making:** This layer represents the highest level, where finance executives contribute to the overall strategic decision-making processes, advising top management of the company.

## IV. The Importance of a Startup Business Plan

When starting your business venture, a business plan is a vital tool to have on hand. It helps in maintaining focus throughout the journey and keeps the company's short-term and long-term goals in hindsight.

Some choose to believe that the act of writing down a business plan has been dead for years, but many business experts agree that having a strategic plan for your business is the safest way to start. Even well-thought-out ideas can turn out utterly useless without including proper execution and implementation steps.

### What Is a Business Plan, & What Does It Consist Of?

A business plan is a roadmap that describes your business goals and details how you will accomplish those goals for it to succeed.

Business planning is essential for startups as it allows individuals to break down its elements into meaningful pieces that are easier for you to understand and comprehend. This would most likely include an expense budget, milestones, tasks and responsibilities, and expected outcomes.

A smart entrepreneur will pay close attention to how much money the business is bringing in and its expenditure. This comes in handy when you're planning to recruit new employees or purchase new equipment. Outlining such needs in a solid financial plan helps you assess how much capital your business needs to grow and function efficiently.

There are three common types of business plans which are used as per the business objectives of a startup:

**1. The Lean Business Plan:** A lean plan deals with the formalities required when presenting a plan for a loan or investment. It focuses on your main business strategy, objectives, tools and equipment, budget estimation, and forecasts. These are used as tools to promote strategic planning and growth within the business.

Lean business plans include more financial data but skip sections like company history and the management team, as the focus is mostly on projected sales, expenditure, and cash flow.

**2. One-page Business Plan:** A simple one-page format outlines your business objectives and goals within a single page. Everything deemed important is listed in concise points that are easy to interpret and understand by anyone.

This kind of business plan is great for startups wishing to summarize their concept effectively. Sticking to a single page allows you to revisit the general model whenever needed without rummaging through different pages each time. Similarly, it's easier to tweak and refine as you come up with new ideas and schemes.

Moreover, it can be used to introduce the business to potential stakeholders with limited time to read through a comprehensive document. This is preferable during initial meetings as it provides them with a general idea of your business model. A detailed plan can be prepared later in the future, but a one-page plan is a better approach to convey your business concept.

**3. Formal or External Business Plan:** Formal business plan documents are typically intended for outsiders to provide comprehensive information about a business and its aims. They are primarily used to convince investors to fund an enterprise or to support a loan application. This type of plan should be designed to look professional, with extra attention paid to detail in language and formatting.
The formal business plan will explain where and how the funding would be used and what return is expected from their investment. Finally, a detailed list of your skilled team should be included to showcase that you have a strong team to help your business grow.

## V. Why Is a Startup Business Plan Important?

To solidify the reasons why business plans are still relevant, we've explained the importance of writing a business plan for startups below:

**1. Plotting a Course:** Business plans provide individuals with the opportunity to think long-

-term. They outline the directions to follow, the goals and aims of your business, the expected outcomes, and other futuristic objectives to help your business grow. Their purpose is to keep entrepreneurs focused through every phase of their business venture and not disrupt the flow.

Additionally, business plans help in briefing recruits, management teams, and employees, allowing you to share your business objectives and motivate them to work towards those goals.

**2. Securing Funding:** It's no secret that businesses can't function without operating capital to kick-start their production cycle. Entrepreneurs are often required to take loans from financial institutions to purchase property, acquire equipment, or hire manpower. However, for this to work out the way you want, you need to present an up-to-date business plan to potential financiers. An accurately plotted business plan will highlight all the capital requirements and serve as written proof for the deed. The better the business plan, the higher the chances of securing reliable suppliers.

**3. Identifying Possible Weaknesses:** If this is your first startup rodeo, there is a high probability of encountering several pitfalls in your business venture, which is completely normal. Highs and lows are a part of life, and without them, we wouldn't feel the need for improvement.

A business plan allows you to reduce the chance of consequences so you can focus on other aspects of business operation. It eliminates spots for unnecessary errors that are time-wasting and highlights areas that can be improved with modern tools and technology. It also allows you to recognize which regions are better handled by automated technology and which can be appointed to manpower.

**4. Execution Plan:** Describing how your business will function and perform in the market is crucial when dealing with sponsors and investors. A business plan explains your products and services, your target customers, the required funds, and what's necessary for your startup to thrive. It guides you through the initial stages, rotating motivation and focus within the business.

If you're unable to remember important details, having a business plan on hand will assist you in employing staff and distributing the workload for smooth operation. For instance, if your business specializes in web design and development services, your target audience is individuals looking to launch or revamp websites for their blog or company. Failing to present any aspect of your business can lead to confusion and cost you a financier before you've even started running.

**5. The Best Possible Chance to Succeed:** Taking time to thoroughly analyze the elements included in writing the best business plan for your startup is guaranteed to bring you success. It allows you to work through essential business details like financing and market planning, so you're not going in blind.

You will be entering the field knowing your target audience and implementing the best strategies to pique their interest. Having a business plan helps you present your ideas and concepts to investors, sponsors, and potential clients, convincing them of your commitment to the enterprise and its success.

Using your business plan as a constant management tool is the best way to benefit from it. For this, your plan must be regularly revised and polished to include updates on current conditions and any new data gathered while running your business.

You're constantly learning new things while managing a business, such as a customer's response to your services, their likes and dislikes, effective marketing techniques, and affairs that require immediate attention. This keeps you on your toes and determined to succeed. It's essential to understand that a business plan intended for internal management and strategic planning within the business walls differs in length, detail, and presentation.

On the other end of the spectrum, a business plan document meant for outsiders like venture capitalists will focus on high-growth aspects of the business and have a much more sophisticated arrangement.

Ultimately, constructing a startup business plan involves a lot of thought and research. You must focus on its core principles and identify what's best for effective management and functioning. Providing adequate information about your startup attracts angel investors and venture capitalists; you just need to apply the right tone and format in your business plan. While it doesn't guarantee success, it can help reduce the likelihood of future failures and raise capital.

## Business Models

Entrepreneurs are on a mission to build the future, and inevitably, they are breaking many rules to create their own. One of the key moments for establishing your company is choosing the right business model for your startup. This decision is essential for entrepreneurs, as going B2B or B2C can significantly shape the future success of your business. Like everything else in your startup, choosing the business model depends on the nature of your products and services and their actual implementation.

The choice of a business model requires a thorough overview of the essence of your startup. Some businesses are more suited to embrace B2B models, and vice versa.

B2C is all about trends, and even though the market size is relatively large, it is strongly affected by changes in tendencies. B2C companies must be flexible and ready for fast changes.

Starting a business with a B2B model is a challenging endeavor, but for serious and competent startup founders, it is a path worth taking. With the B2B model, not only must the product be robust, but the entire team, especially the marketing specialists, needs to be highly qualified. Success in the B2B realm is closely tied to the strength of the idea's execution.

This model is strongly relationship-driven, and startups embracing it often aim to collaborate with the most powerful players in the market, seeking to attract them as customers.
B2B models demand hard work and professionalism. However, when the business becomes successful, the high pricing associated with B2B transactions ensures high revenues.

## VI. Business Model vs Business Plan

Many entrepreneurs get confused with the business model and business plan, and it's important to understand the differences between them:

## VII. Business Model Canvas

The business model canvas is an essential tool used by many startups worldwide to build their business models. According to the business model canvas, every business model has 9 components:

| | |
|---|---|
| Customers segments | Revenue streams |
| Value propositions | Key activities |
| Channels | Key resources |
| Customer relationships | Key partnerships |
| | Cost structure |

Each component of the Business Model Canvas is crucial, and attention should be given to all nine. For example, the value proposition is meant to communicate the value that your product or service can provide to your customers. The Business Model will help you create value for your customers, and in the long term, that is the most important aspect for your business.

Understanding your customer segment requires developing a customer strategy with the customer segment component of the Business Model Canvas. The customer segments are specific groups of people or businesses that your startup aims to reach and serve. You can also choose between different types of customers that are appropriate for your startup.

Therefore, if you want to be a successful entrepreneur, you need to focus on your Business Model. Pay attention to the Business Model that your startup has created and turn it into an advantage for your business.

| Business Plan | Business Model |
|---|---|
| A detailed document defining the objectives, goals of the business and how they will achieve it. | A detailed plan of how the business plans to achieve profitability by delivering and capturing value. |
| Addresses the short-term and long-term goals of the business | A conceptual framework on how the business intends to make money. |
| Business plans are often created for the potential investors and other external stakeholders | Business models are primarily for executives and internal members within a company |
| Serves as a formal document for securing funding or support from external stakeholders | Can be represented using different frameworks, like the canvas model or the value chain. |

*Below is an example of Netflix's business model:*

**Netflix:** Netflix is a global streaming giant, offering a vast library of TV shows, movies, and documentaries. Known for its subscription-based model, Netflix has revolutionized how audiences consume entertainment, providing original content alongside licensed productions. With a personalized recommendation system, it reaches millions of subscribers worldwide, making it a leading player in the streaming industry.

**Customer Segments of Netflix:** The Netflix platform is designed to cater to a wide range of subscribers, offering a diverse catalog that includes films, series, documentaries, and shows across various genres, suitable for all ages and preferences.

The customer segmentation for Netflix is both usage-based and geographical. This segmentation helps identify the types of content that work best for each audience.

**Value Proposition of Netflix:**
Netflix's entire value proposition is linked to the fact that it provides quality entertainment to its user, 24/7. This proposition includes:

- Access to a huge catalogue of products, with content for all tastes.
- On-demand streaming, with 24/7 access – without ads
- Possibility of binge-watching.
- Offering personalized lists and recommendations, based on the content watched.
- Original and high-definition content.
- User accounts, which allow each person in the family to have a personalized profile.
- All of this on any device connected to the internet.

**Key Partners of Netflix:** Netflix has a diverse array of key partners, including:

- Media producers and TV networks: They license their content to Netflix.
- Consumer electronics producers: Companies such as Wii, Xbox, and PlayStation bundle Netflix with their systems.
- Amazon AWS: Netflix's platform is entirely hosted on AWS.
- Investors and regulators.

These key partners play crucial roles in supporting and contributing to Netflix's success.

**Key Activities of Netflix:** Netflix's key activities revolve around offering the best streaming content experience to its users. This involves not only investing in technology and hiring and retaining talent to maintain high-performance platform operations but also a strong focus on content offerings.

In addition to maintaining and expanding its platform on the website and apps, Netflix must produce, select, license, and acquire relevant content. The company needs to build partnerships, negotiate with studios, content producers, and movie production houses, all while analyzing and understanding customer behavior to enhance their experience.

Last but not least, Netflix must continually develop its subscription model and pricing strategy to both retain and grow its customer base.

**Key Resources of Netflix:** Apart from its own platform, website, and app, Netflix's key resources primarily consist of human and digital resources.

These include software developers, the content library, the recommendation algorithm, filmmakers and producers, the brand, and the studios that Netflix is developing to support its creations. These resources collectively contribute to Netflix's ability to provide a diverse and high-quality streaming experience for its users.

**Customer Relationships of Netflix:** Netflix's customer relationships are primarily built on the platform itself. Firstly, it is user-friendly, allowing users to configure it to their preferences. Secondly, Netflix utilizes an algorithm that suggests content based on users' consumption patterns.

Netflix's user support is accessible through various channels, including the website, email, chat, and telephone. The company's robust presence on social media platforms such as Instagram, Facebook, and LinkedIn enhances customer relationships. Netflix actively engages with its audience on these networks, providing updates about releases and promotions and responding to a significant portion of comments on their posts. This interactive approach strengthens the bond between Netflix and its users.

**Channels of Netflix:** The primary channels for Netflix are undoubtedly its own website and app. However, the company also invests in online and offline advertising, leverages social media, and benefits significantly from word of mouth among its users.

**Cost Structure of Netflix:** Netflix's cost structure is substantial, explaining the challenges with cash flow during its initial years as the new business model required significant investment. This extensive cost structure includes:

- Producing movies, series, and other new content
- Purchasing content and rights
- Providing recommendations through artificial intelligence
- Platform maintenance
- Data centers for streaming content
- Research, patents, and software development
- Amazon AWS and technology
- Marketing, human resources, and infrastructure

These various elements contribute to the overall cost structure that Netflix has incurred in establishing its position in the industry.

**Revenue Streams of Netflix:** As Netflix's business model is grounded on subscriptions, its primary revenue streams are derived from the monthly fees paid by its millions of subscribers.

However, as highlighted earlier, Netflix's cost structure is substantial, prompting scrutiny into the company's overall profitability. Let's delve a bit deeper into this aspect.

## VIII. What is Financial Planning and Analysis?

Once you are clear on your business model and business plan, it's crucial to assess how you measure the effectiveness of their execution. This is where Financial Planning & Analysis (FP&A) plays a major role for your startup.

In simple terms, FP&A is the process of determining how your company will afford to achieve its vision, strategic goals, and objectives. While accounting is about looking backward, FP&A is about looking forward.

In the startup world, the importance of planning becomes evident when you observe companies with no revenue but substantial valuations. Much of a company's value comes from its projected future earnings. Regardless of your company's size, engaging in budgeting, forecasting, and analysis that supports major executive decisions is essential.

Building the necessary financial talent in a startup or small company is a gradual process. In a new venture, the FP&A function is often handled by the founders with outsourced assistance from virtual CFOs or analysts. As the company grows, the controller or CFO typically takes charge of FP&A. Eventually, as the company becomes larger, investing in a full-time FP&A team becomes a valuable proposition.

To ensure that the value chain, cash cycle, and other economic fundamentals align with the business opportunity and overall company strategies, seek answers to the following questions:

- What are your gross and operating margins?
- What is your profit potential?
- How durable is the stream of profits?
- What variables determine pricing and produce profits?
- What are your fixed, variable, and semi-variable costs?
- What assets are used and will be used in the business?
- How many months to break even given your proposed financing?
- How many months to reach positive cash flow?
- When will you run out of cash?
- Can you foresee any significant changes in cash flow as you grow?

In high-growth environments, organizational development is often a key factor, so don't forget to include staff assumptions as well. More employees will bring about more complexity and the need for additional financing.

## About Spice Route Finance

Spice Route Finance helps startups, early stage and growth stage companies create change that matters. We partner with our clients to identify and overcome the most critical challenges and deliver value by uncovering opportunities.

From leadership to execution, we help our clients to transform their organizations through our in-depth expertise in financial strategy, interim leadership, business strategy, and deal advisory. This means embedding excellence in financial decision making, analytics, and design into core processes and mindsets; building capabilities that help businesses thrive in the face of rapid disruption; and developing successful execution models to ensure that ideas translate into outcomes, quickly and sustainably.

*This eBook has been compiled to help startups to give a flavor of why accounting and finance is important for all startups irrespective of size and segment.*

*If there is any area which you need any specific guidance or help please do not hesitate to reach out to the founder at* ***sriram@spiceroutefinance.com***