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Financial Planning as a Management Model

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Abstract

This article addresses the shortcomings in the strategic planning of companies and presents the conclusions about their possible solutions that are crucial to ensure their sustainability and growth. The implementation of this type of solution will allow companies to improve their strategic planning, ensure their financial sustainability and position themselves competitively in the market. It also emerges that the adoption of sound financial practices and the use of appropriate management tools are essential to face the challenges of the business environment and take advantage of growth opportunities.

Keywords: *Strategic Planning, Sustainability, Growth, Management Model, Financial Planning.*

Introduction

Financial planning is a key tool in the management of any company, regardless of its size or sector, for entrepreneurs, its relevance is even greater, since it determines if a newly created company can overcome the initial challenges and consolidate in the market, which is why in many developing countries, the lack of adequate financial planning is one of the main reasons why many companies fail to survive the future. In this context, the study by Correa García et al. (2010) highlights seven common shortcomings in the financial planning of entrepreneurs, the consequences of which can be devastating for new companies. These errors will then be explored and how they can be mitigated through proper financial planning.

Development

In the dynamic world of entrepreneurship, financial planning stands as a cornerstone for success. However, many entrepreneurs, driven by their passion and vision, often underestimate the importance of a robust financial strategy.

In the article from the Universidad Militar Nueva Granada, seven common shortcomings in the financial planning of Colombian entrepreneurs are identified:

Lack of financial foresight.

Underestimation of costs.

Lack of long-term planning.

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Inadequate management of resources.

Excessive dependence on external financing.

Lack of financial control and monitoring.

Lack of knowledge of financial tools.

These shortcomings are analyzed below, from lack of foresight to inadequate management of resources. Through its analysis, it seeks not only to identify these errors, but also to propose practical solutions that can guide entrepreneurs towards a more sustainable and successful future.

The article developed by Correa García, Ramírez Bedoya & Castaño Ríos (2020), develops the importance of Financial Planning, determining it as crucial for the sustainability of emerging companies and its impact on business development. Likewise, it defines a business plan as a document that evaluates the commercial, technical, legal, administrative and financial viability of a project, considering as key components of the Business Plan the market analysis, legal, technical, administrative, social and environmental impact studies, and finally the financial study. The central theme of the article describes the common shortcomings in Financial Planning, identifying seven common shortcomings among entrepreneurs, such as excessively optimistic income projections and lack of capital budgets, among others.

Shortcoming No. 1: Revenue projections not in line with costs and expenses

One of the most frequent shortcomings is the overestimation of future revenues, without taking into account the associated costs and expenses, this vision of excessive optimism can lead to a lack of liquidity when expectations are not met, realistic financial planning must include conservative scenarios and take into account market variability to prevent the company from being compromised in its cash flow. Not only do they represent isolated errors, but they are interconnected and have a cumulative impact on the viability of a business, the impact of each of these failures is intensified when entrepreneurs lack proper training in financial management, compounding the problems as the business grows. This is perhaps the most dangerous flaw, as it tends to inflate entrepreneurs' expectations regarding the performance of their business, revenue projections that do not take into account real costs and expenses can give a false sense of security, when a company begins to operate under these unrealistic expectations, it can end up underestimating its capital needs, which in turn leads to liquidity problems, instead of relying exclusively on optimistic scenarios, financial planning must be based on multiple scenarios, including the most conservative ones, to avoid these imbalances.

Significance: Inflated revenue projections can lead to erroneous financial decisions, such as overinvesting in resources or underestimating the need for financing.

Risk level: High. It can result in liquidity problems and the inability to cover operating costs.

Improvement actions:

- Perform detailed and conservative market analyses.
- Implement periodic reviews of financial projections.
- Use sensitivity scenarios to evaluate different possible outcomes.

Shortcoming No. 2: Lack of capital budgets for the acquisition of property, plant and equipment

Many entrepreneurs do not adequately plan investments in fixed assets over time, which can result in technological obsolescence or inability to scale production, so the acquisition and renewal of equipment

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must be an integral part of any financial projection, especially in sectors such as manufacturing and technology, where productive capacity is key to growth. Failing to consider investment in infrastructure and equipment can doom a company to failure in the long run. In many cases, entrepreneurs do not take into account the depreciation of assets or the need for renewal, which affects the productivity and competitiveness of the business, this problem is common in capital-intensive industries, such as manufacturing or technology, where the lack of investment in new technologies can lead to obsolescence, Companies must integrate these costs into their financial planning to ensure that they have the necessary resources to maintain or increase their productive capacity.

Importance: Lack of planning for asset renewal can lead to technological obsolescence and loss of competitiveness.

Risk level: High. It can affect the operational capacity and quality of products or services.

Improvement actions:

- Establish a capital budget that includes depreciation and obsolescence.
- Conduct regular audits of assets to assess their condition and need for replacement.
- Implement a preventive maintenance plan.

Fallacy No. 3: Distribution of profits without considering free cash flow

A critical flaw is the distribution of profits based solely on net income, without taking into account free cash flow, this approach can lead to situations where the company runs out of capital for future operations or strategic investments, compromising its long-term viability. The confusion between accounting profits and free cash flow is a critical mistake, a company may be generating profits on paper, but if it does not have enough free cash flow, it will not be able to sustain its operations. The distribution of profits in these circumstances can result in a lack of working capital, leading to insolvency. These types of mistakes are common in entrepreneurs who focus more on short-term profits than on the long-term viability of their company.

Importance: Distributing profits without considering cash flow can lead to liquidity problems and the inability to finance future operations.

Risk level: Medium-High. It can affect financial stability in the short term.

Improvement actions:

- Evaluate free cash flow before making decisions about profit distribution.
- Implement earnings retention policies to ensure sufficient funds for operations and growth.
- Perform projected cash flow analysis.

Fallacy No. 4: Sales growth above installed capacity with no expansion plans

Projecting a growth in sales that exceeds installed capacity is another frequent mistake, in this way companies must ensure that their resources, both human and material, are aligned with their expansion goals, not doing so can lead to bottlenecks in production or inability to meet market demand. Rapid growth without the adequate infrastructure to support it is a recipe for failure, in many cases, entrepreneurs manage to increase their sales, but find that their installed capacity cannot meet the demand, this generates dissatisfaction among customers, quality problems and, finally, loss of market, financial planning must

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foresee these scenarios and ensure that any projection of growth in sales is supported by a corresponding investment in infrastructure and personnel.

Importance: Growth in sales without adequate production capacity can lead to customer dissatisfaction and loss of market.

Risk level: High. It can result in operational bottlenecks and the inability to meet demand.

Improvement actions:

- Develop capacity expansion plans aligned with sales projections.
- Implement operational efficiency improvements to maximize existing capacity.
- Perform capacity and demand analysis regularly.

Fallacy No. 5 Initial losses that generate cause for dissolution.

In many countries, commercial laws establish grounds for dissolution for companies that incur losses that reduce their subscribed capital below a certain threshold, to avoid this risk, it is crucial that entrepreneurs plan financially with enough margin to cover the initial losses. Thus, companies that experience prolonged losses are forced to dissolve if they fail to recapitalize and this is why many times, entrepreneurs do not plan adequately to cover the initial losses, which puts them at risk of dissolution, this problem can be mitigated with adequate financial planning that contemplates a capital cushion to face the first years of operation. which are the most critical to a company's survival.

Significance: Significant initial losses can jeopardize the viability of the business and lead to dissolution.

Risk level: High. It can result in the total loss of the invested capital.

Improvement actions:

- Establish capital reserves to cover initial losses.
- Implement cost reduction and efficiency improvement strategies.
- Perform feasibility analysis and contingency plans.

Fallacy No. 6: Poor cost estimation.

Underestimation of costs is one of the main reasons why many businesses fail, proper financial planning should include a detailed assessment of all costs associated with the operation, from inputs to salaries to administrative expenses. Ignoring any of these elements can have negative consequences for the company's profitability. Underestimating costs is one of the most common mistakes in financial planning. This is due, in large part, to the lack of detailed analysis of all the factors that affect the operation of a company. Costs such as taxes, duties, service fees, equipment maintenance, and other unforeseen events are often overlooked, which can cause profit margins to be much lower than projected, this type of mistake directly affects profitability and can make a seemingly profitable business unviable.

Importance: Underestimating costs can lead to profitability issues and the inability to cover operating expenses.

Risk level: High. It can affect the financial sustainability of the business.

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Improvement actions:

- Perform detailed cost and budget analyses.
- Implement cost control systems and regular audits.
- Use cost management tools and specialized software.

Fallacy No. 7 Insufficient debt for long-term growth

Finally, many entrepreneurs choose to minimize long-term debt, which limits their ability to grow and compete in the market. A prudent use of debt can be an effective tool to finance the company's expansion, improve its infrastructure and increase its operational capacity. The fear of debt is a barrier that limits the growth of many companies, although it is true that excess debt can be dangerous, the absence of strategic debt can prevent a company from reaching its full potential, the key is to find an adequate balance, where external financing is used prudently to expand operations, Improving efficiency or exploring new market opportunities, entrepreneurs must understand that well-managed debt can be a valuable tool to accelerate the growth of their company. It is very important to understand that any debt that yields above operating expenses, its own interests with an adequate margin is an asset for the company, in that case it is important to pilot the project and keep it in that state, without excessive debt limiting the free cash flow that the business needs to maintain itself. Evergrande, the Chinese real estate giant, faced a financial crisis due to its excessive indebtedness, the company took massive loans to expand, but was unable to generate enough cash flow to cover its debts, the lack of a proper plan to manage its long-term debt resulted in defaults, collapsing its value and affecting the global economy.

Importance: Ignoring long-term borrowing can lead to a lack of financing for future projects and an inefficient capital structure.

Risk level: Medium. It can limit the capacity for growth and expansion.

Improvement actions:

- Regularly assess capital structure and level of indebtedness.
- Implement long-term financing policies.
- Perform cost-benefit analyses of different financing options.

Table 1. Description of Shortcomings in Business Plans of Entrepreneurs Who Are Unaware of the Benefits of Adequate Financial Planning.

Bankruptcy	Importance	Risk Level	Improvement Actions
Very high revenue projections	Wrong financial decisions	High	Conservative market analysis, periodic reviews, sensitivity scenarios
Lack of capital budgets	Technological obsolescence	High	Capital budgeting, asset audits, preventive maintenance

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Bankruptcy	Importance	Risk Level	Improvement Actions
Distribution of profits without considering cash flow	Liquidity problems	Medium-High	Evaluate free cash flow, earnings retention policies, projected cash flow analysis
Sales growth without expansion plans	Customer dissatisfaction	High	Capacity expansion plans, operational efficiency improvements, capacity and demand analysis
Significant initial losses	Risk of dissolution	High	Capital reserves, cost reduction strategies, feasibility analysis
Poor cost estimation	Profitability issues	High	Detailed cost analysis, cost control systems, cost management tools
Ignored long-term debt	Lack of future funding	Middle	Capital structure assessment, long-term financing policies, cost-benefit analysis

SOURCE: Own condensation from (CORREA GARCÍA, RAMÍREZ BEDOYA, & CASTAÑO RÍOS, 2010)

Conclusions

Financial planning is essential for the sustainability of any company, the seven shortcomings identified by Correa García et al. (2010) are common mistakes that, if not properly addressed, can jeopardize the success of ventures, the solution lies in comprehensive financial planning that includes realistic projections, cost control, an appropriate use of debt and a distribution of profits based on free cash flow. ix In addition, in the Colombian context, financial planning must take into account specific market challenges, such as economic instability and lack of access to financing, which makes the need to anticipate contingencies and adjust financial projections conservatively even more important. Financial planning is essential to ensure the sustainability and long-term growth of a company. Common shortcomings, such as underestimation of costs, lack of realistic revenue projection, and insufficient or poorly managed indebtedness, can have devastating effects on the development of any venture, cases such as Evergrande and Avianca illustrate how the lack of adequate debt and resource management can lead to collapse, even in large corporations. To avoid these mistakes, entrepreneurs must adopt comprehensive financial planning, which contemplates realistic scenarios, efficiently manages resources, and focuses on long-term stability beyond immediate growth. Only through solid planning, supported by exhaustive financial analysis, can the creation of sustainable and competitive companies be achieved over time.

Addressing shortcomings in companies' strategic planning is crucial to ensure their sustainability and growth. The following are the conclusions on the possible solutions to these shortcomings, applied specifically to those described in the article proposed for study:

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- Realistic revenue projections: It is critical for Colombian companies to make revenue projections based on detailed and conservative market analysis. This will allow you to make better financial decisions and avoid liquidity problems. Implementing periodic reviews and using sensitivity scenarios will help adjust projections based on market conditions.

- Adequate capital budgets: Planning for the acquisition and renovation of property, plant, and equipment should include consideration of asset obsolescence. Establishing a capital budget that includes depreciation and carrying out periodic audits of assets will allow companies to maintain their competitiveness and operability.

- Cash flow-based profit distribution: Before distributing profits, it is essential to evaluate the project's free cash flow. This will avoid liquidity issues and ensure that companies have sufficient funds to fund their operations and growth. Implementing earnings retention policies and performing projected cash flow analysis are best practices.

- Expansion plans aligned with sales growth: Companies should develop capacity expansion plans that are aligned with their sales projections. This will avoid operational bottlenecks and ensure customer satisfaction. Improving operational efficiency and conducting regular capacity and demand analyses are key actions to achieve this.

- Managing Initial Losses: Establishing capital reserves to cover initial losses is a crucial strategy to avoid dissolution of the company. In addition, implementing strategies to reduce costs and improve operational efficiency will help mitigate the impact of initial losses and ensure the viability of the business.

- Accurate cost estimation: Performing detailed cost and budget analyses is essential to avoid profitability issues. Companies should implement cost control systems and regular audits, as well as use cost management tools and specialized software to have a clear view of their expenses.

- Long-term debt management: Regularly assessing the capital structure and level of indebtedness will allow Colombian companies to maintain a healthy financial structure. Implementing long-term financing policies and conducting cost-benefit analyses of different financing options are best practices to ensure growth and expansion capacity.

In summary, the implementation of this type of solutions will allow companies to improve their strategic planning, ensure their financial sustainability and position themselves competitively in the market. The adoption of sound financial practices and the use of appropriate management tools are essential to meet the challenges of the business environment and take advantage of growth opportunities.

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