
MSA 643

Sport Finance

Belhaven University

Unit 3

Budgeting 101

Topics

- Budgeting 101
 - Importance of Financial Planning
 - Determining Financial Objectives
 - Financial Planning Process
 - Developing a Pro Forma Budget
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Introduction

- This unit begins with examining the importance of financial planning.
 - It will also highlight the various components necessary to assist a person to plan effectively.
 - The last section of this unit deals with developing a pro forma budget as a key to writing an effective business plan.
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Objectives

- Appreciate the need and value of financial planning.
 - Understand the value and use of budgets.
 - Appreciate the data that must be gathered to plan and create budgets.
 - Follow all the steps involved in the financial planning process.
 - Define financial planning.
 - Distinguish between long-term and short-term financial planning and understand how to minimize risk.
 - Understand what a pro forma budget is and why it is important.
 - Know how to develop a comprehensive business plan for a new and existing business.
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Importance of Financial Planning

- Financial planning can help provide appropriate solutions for the types of problems businesses face every day, such as the need to
 - ❑ develop new products,
 - ❑ spend more money on research and development,
 - ❑ borrow funds for future expansion,
 - ❑ issue more stocks,
 - ❑ issue more bonds,
 - ❑ sell existing assets,
 - ❑ purchase new assets,
 - ❑ move the business to another location,
 - ❑ acquire a competing company,
 - ❑ file for bankruptcy protection.
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Importance of Financial Planning, cont.

■ Texas Rangers and Alex Rodriguez

- ❑ In December 2000, the Rangers signed free agent Alex Rodriguez to a 10-year \$252 million contract.
- ❑ Increase in ticket prices: Individual tickets cost \$2 more (average ticket price now \$22.08), club seats increased from \$25 to \$40, and upper reserved seats and bleacher seats went from \$10 to \$12.
- ❑ Attendance fluctuated throughout A-Rod's career with the team; his presence did not produce significant attendance or revenue growth.
- ❑ It is not unusual for teams to leverage new stars, and their large salaries, by raising ticket prices.

Importance of Financial Planning, cont.

■ **Texas Rangers and Alex Rodriguez, cont.**

- The same year the Rangers signed A-Rod, they signed a 10-year \$250 million broadcast contract with Fox.
 - This covered Rodriguez's contract, leaving other revenue such as ticket sales and souvenirs to cover other payroll obligations.
 - The Rangers thought A-Rod would be their savior on and off the field, but after several years the reality unfolded that they miscalculated both expectations.
 - Such player transactions show the importance of sound and thorough financial planning in sports and of not relying solely on one player to fix any financial or attendance woes.
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Budgeting

- A budget is a road map that shows where the sport business intends to spend its money.
 - Example of sport budgeting: going to a postseason football bowl game.
 - Need to properly account for any potential transportation, housing, food, and related expenses
 - Need to include the cost of purchasing tickets to sell to fans
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Budgeting, cont.

- In 2011, the University of Connecticut, as the Big East champions, were invited to play a New Year's bowl game against the Oklahoma Sooners.
 - UConn was able to sell only 4,600 tickets for around \$646,000 against a guarantee of \$3.35 million.
 - Only 2,771 of those tickets went to the general public, who paid from \$105 to \$255 per ticket.
 - UConn generated around \$3.2 million from the game but incurred \$4.86 million in expenses, resulting in a loss of \$1.66 million.
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University Athletic Department Foundation

Revenue and expenses for a sample collegiate athletic foundation are broken down in amounts and percentage of total funds for various categories.

Revenue

Fund-raising and annual campaign (45.4%)	\$3,220,266
Direct mail and telemarketing (27.2%)	1,936,589
Investment income (11.8%)	838,773
Program services (5.6%)	395,540
Game sponsors (5.2%)	366,930
Foundations and grants (3.0%)	215,007
Souvenir sales (1.8%)	126,895
Total revenue	\$7,100,000

University Athletic Department Foundation, cont.

Expenses

Program services (52.8%)	3,742,385
Revenue development (17.6%)	1,252,106
Net asset increase (14.1%)	1,001,196
Direct mail and telemarketing (8.9%)	634,965
Management and general (6.6%)	469,348
Total expenses	\$7,100,000

University Athletic Department Foundation, cont.

- Among the stories these numbers tell are the following:
 - ❑ More than 50% of all moneys raised helped pay for program services.
 - ❑ Investment income will increase on an annual basis if the athletic foundation continues increasing its net assets, because the primary assets are investment securities that will generate future income.
 - ❑ Only 6.6% of expenses were dedicated to managerial tasks, while 26.5% of expenses helped raise operating funds. Thus, over a quarter of the expenses were used to raise money.
 - ❑ Although direct mail and telemarketing costs were \$634,965, this investment was very successful in helping to raise almost \$2 million.
 - ❑ The greatest revenue source came from fund-raising efforts and donations by individuals to the annual campaign.
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University Athletic Department Foundation, cont.

- Based on these numbers, a budget could be developed for 2012 highlighting possible additional anticipated revenue from programs that are doing well.
 - Future expenses also might increase if there are different priorities or if additional expenses are anticipated for various activities.
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Data for Financial Planning

- **Internal Data:** Often referred to as primary data; this information is generated by the business itself.
 - **External Data:** Data obtained from other sources; also known as secondary data. Can come from newspapers, databases, teams, leagues, trade associations, and countless other sources.
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Internal Data

- Internal data can include past balance sheets and income statements, audited financial records, annual reports, research and development reports, e-mails, surveys, and countless other documents generated by employees or consultants.
 - By breaking its operation down into its basic elements based on internal data, a team can develop a more appropriate budget.
 - One example is zero-based budgeting where every expenditure is justified in comparison with other potential projects in the organization. Determinations are made based on internal projections.
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External Data

- Here are some examples of gathering external data:
 - ❑ Monitoring reports of international terrorist activities to determine if an event needs to be canceled
 - ❑ Analyzing industry trends to develop appropriate pricing for concession items
 - ❑ Tracking culinary advances to determine the most effective means of packaging and selling food items
 - ❑ Reading current articles in trade publications to stay abreast of industry changes (e.g., *Barron's*, *Forbes*, *Bloomberg Businessweek*, and *Wall Street Journal*)
 - ❑ Attending conferences to hear what other executives are saying about the industry.
 - ❑ Reviewing government census reports to understand demographic changes in the possible fan base.

Forecasting

- Companies and sports organizations need to look to the future when undergoing financial planning.
- Forecasting involves uncertainty and historical performance, and it is usually less accurate than desired. Experience is often the best teacher of what really works.
- Information for forecasting can come from the following:
 - Quantitative data (regression analysis, econometrics, naïve estimation, and smoothing)
 - Qualitative data (market research, sales force estimates, and focus groups)
- The most common approach for forecasting is the prior year's actual revenues adjusted subjectively.

Short-Term Planning

- Short-term planning dictates how a business should proceed in a short time frame, usually less than two years.
 - Planning is based on specific research and requires people to meet specific goals.
 - It requires close scrutiny of internal variables such as cash flow and debt-related issues.
 - Key aspects of short-term planning include how to effectively understand and make decisions based on working capital, net working capital, current ratio, acid test ratio, and the cash budget.
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Long-Term Planning

- Long-term planning is often less clear because there are too many variables to allow for making accurate projections.
 - Greater emphasis is placed on future external variables, such as industry trends, political climates, and technological advancements.
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Special Situations in Financial Planning

■ **Start-ups**

- ❑ There is no established track record for the business on which to base planning.
- ❑ Pro forma balance sheets and income statements for new businesses are very speculative.

■ **Ownership Changes**

- ❑ If ownership change resulted from poor business performance, new ownership is probably going to institute changes in management; company will need to change its direction.
 - ❑ May lose customers or employees.
 - ❑ May need to reexamine product lines and markets to help with sales and start to turn a profit.
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Special Situations in Financial Planning, cont.

■ Fast Growth

- It is a mistake to assume fast growth will continue forever into the future.
- Businesses seizing new market niches or that enter new and growing markets are typically the ones associated with abnormally high growth.
 - These are the types of businesses that are at risk as other entrants, having witnessed the explosion in growth, try to steal market share (think about the growth of Silly Bandz and knockoffs).

Developing a Pro Forma Budget

- A pro forma budget is simply a future budget based on past financial results and expected future financial results.
 - It contains a financial plan for the business.
 - The two are often combined to help complete the business plan.
 - Typical extensive pro forma budgets might incorporate the following:
 - A sales budget
 - A promotion budget
 - A materials, labor, and overhead budget
 - A cash budget
 - A capital appreciation budget
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Developing a Pro Forma Budget, cont.

■ Financial Plan in Five Steps

1. Develop a system of projected financial statements, which can help a company analyze how the operating plan will affect the projected profits.
2. Determine the funds that will be needed to help fund the long-term plans.
3. Forecast what funds will be available over the long term and how much of the funding will be generated internally and externally.
4. Establish and maintain a system of controls governing how funds are allocated and used.
5. Examine the results and develop procedures for adjusting the plan if the forecasts are not met.

Writing a Business Plan

- The plan summary should be written after all other sections are finished. It describes the following:
 - ❑ The purpose of your plan
 - ❑ The product or service that you will sell and why it is unique
 - ❑ Second- or third-generation products or services to help maintain sales
 - ❑ The market potential
 - ❑ Specific highlights in the marketing plan
 - ❑ The skills provided by the management team
 - ❑ The financial projections for the first several years
 - ❑ Your funding needs
 - ❑ An exit strategy if the business does not succeed
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Writing a Business Plan, cont.

■ **Industry Section**

- Highlight the economics in the industry, industry trends, and potential legal or regulatory concerns.
- Critically analyze the competitive forces you might face.

■ **Company Section**

- Review the history and background of the business. It can include the mission statement, objectives, goals (long term and short term), and strategies.
 - List the current principal owner(s) or majority stockholder(s), all members of the board of directors (if applicable), and all key executives.
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Writing a Business Plan, cont.

■ **Special Circumstances**

- ❑ For example, what stock purchase options exist if the company goes public? Do key employees have non-compete contracts?
- ❑ Any data an investor would need to make an investment decision should be included.

■ **Analysis of the Product or Service**

- ❑ Include a thorough analysis of the product's or service's unique qualities, which will help distinguish the product or service from those offered by competitors.
 - ❑ The plan should identify any ancillary products or services that also might be produced to develop a more significant product or service line.
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Writing a Business Plan, cont.

■ **Market Section**

- ❑ This section focuses on the demographic characteristics of the proposed market.
- ❑ Who is the target market? What is its size? Can these people be reached? And do they have the funds necessary to purchase the product or service?

■ **Marketing Strategy Section**

- ❑ This section focuses on how to sell or distribute the product or service to potential buyers.
 - ❑ Apply the four Ps of marketing—place, product, price, and promotion. Sample brochures, advertisements, announcements, product packaging, product or service guarantees, and related materials should be included.
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Writing a Business Plan, cont.

■ **Operation Section**

- ❑ This section describes how the product will be developed and produced or how the service will be delivered.
- ❑ It should discuss critical dates, such as when production will begin, as well as who will produce the products, where the inventory will come from, what shipping schedule will be followed, how the products will be delivered to clients, and so on.

■ **Management and Personnel Section**

- ❑ This part of the plan lists all the key people necessary for the business to be successful, with brief biographies of past accomplishments along with potential references.
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Writing a Business Plan, cont.

■ **Financial Projections Section**

- This section addresses when investors can make their money back and what profit investors can realize.

■ **Capital Needs Section**

- What funds will be needed to launch the business? When will the funds be needed?
- To help establish potential collateral, the plan should highlight what the funds will be used for.

■ **Miscellaneous Section**

- This part contains relevant pictures, price lists, facility diagrams, and necessary equipment, plus a discussion of any unusual risks.
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Characteristics of Successful Business Plans

1. Clear and realistic financial projections are the most important element.
 2. The plan contains detailed and documented objective market research.
 3. The plan includes a detailed analysis of all competitors.
 4. The plan demonstrates that the management team is more than capable of leading the company.
 5. There is a “killer” summary that is only two or three pages long and includes critical projections such as income statements.
 6. The plan provides proof of the writer’s vision by clearly differentiating the product or service from that of the competition.
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Characteristics of Successful Business Plans, cont.

7. The document follows a clear plan and, most important, is written in proper English that is clear, precise, and free of grammatical mistakes.
 8. The most effective plans are short, rarely exceeding 40 pages. Documents longer than this can become too cumbersome to read.
 9. The writer clearly explains the bottom line—why the money is needed and how investors will be repaid.
 10. The writer has taken the time to make the plan his/her own. When people write business plans using their own words, instead of hiring an outside writer or using canned computer software, the reader has a better feel for their sincerity.
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Questions for Class Discussion

- DQ1: For many managers, making the highest profit possible is a financial objective. Based on the level of athletics you wish to work in, what would be your financial objective? What obstacles may stand in the way from reaching your financial objective?
 - DQ2: Examining internal and external data, where do you see this being beneficial in your athletic career? What are some of the fixed costs you will experience in your athletic field?
 - *Requirements: 250 words minimum initial post, 100 words minimum reply*
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References

■ Required Textbook:

Fried, G., Shapiro, S., & DeSchraver, T. (2013). *Sport Finance*, (3rd ed.). Champaign, IL: Human Kinetics. ISBN 13: 978-1450421041

■ Article Listed for Unit 3:

Hitchcock, M. (nd). *Welcome to Petco Park: Home of Your Enron by the Sea Padres*. Retrieved from http://www.law.berkeley.edu/sugarman/PETCO_Park_and_the_Padres_Mark_Hitchcock.pdf
