11

Chapter Eleven

The Business Plan

Madame, enclosed please find the novel you commissioned. It is in two volumes. If I had had more time I could have written it in one.

Voltaire

Results Expected

Upon completion of this chapter, you will have:

1. Examined a model of a business plan proven and refined over 25 years of actual use.
2. Determined what needs to be included in the plan, why, and for whom.
3. Identified some of the pitfalls in the business plan preparation process and how to avoid these.
4. Analyzed a complete business plan developed by a young entrepreneur to raise capital for a new telecommunications venture.
5. Concluded what has to be done to develop and complete a business plan for your proposed venture.
6. Analyzed the "Douglas Ranalli and Shae Plimley" case.

Developing the Business Plan

The business plan itself is the culmination of a usually lengthy, arduous, creative, and iterative process that, as we explored in Chapters 3 and 4, can transform the caterpillar of a raw idea into the magnificent butterfly of an opportunity. The plan will carefully articulate the merits, requirements, risks, and potential rewards of the opportunity and how it will be seized. It will demonstrate how the four anchors noted in Chapter 4 will reveal themselves to the founders and investors by converting all the research, careful thought, and creative problem solving from the Venture Opportunity Screening Guide into a thorough plan:

1. They create or add significant value to a customer or end user.
2. They do so by solving a significant problem, or meeting a significant want or need for which someone is willing to pay a premium.
3. They therefore have robust market, margin, and money-making characteristics: large enough ($50+ million), high growth (20 percent-plus), high margins (40 percent-plus), strong and early free cash flow (recurring revenue, low assets and working capital), high profit potential (10–15 percent-plus after tax), and offer attractive realizable returns for investors (25–30 percent-plus IRR).
4. They are a good *fit* with the founder(s) and management team at the time and marketspace, and with the risk/reward balance.

The plan becomes the point of departure for prospective investors to begin their due diligence in order to ascertain the various risks and potential of the venture: technology risks, market risks, management risks, competitive and strategic risks, and financial risks. Even if you do not intend to raise outside capital, this homework is vital. The collisions between founders and investors that occur during meetings, discussions, and investigations reveal a great deal to all parties and begin to set the code for their relationship and negotiations. Getting to know each other much more closely is a crucial part of the evaluation process. Constantly on all minds will be such issues as: are these intelligent people; can we work well with them during thick but especially thin times; are they creative; do they listen; can they add value to the venture; is this the right management; do I want them as business partners; are they honest; are we having fun yet?

The investors who can bring the most insight, know-how, and contacts to the venture, and thus add the greatest value, will reveal themselves as well. The most valuable investors will see weaknesses, even flaws, in how the market is viewed, the technology or service, the strategies, the proposed size and structure of the financing, and the team, and will propose strategies and people to correct these. If it is the right investor, it can make the difference between an average and a good or great venture.

The Plan Is Obsolete at the Printer

The author has argued for three decades that the plan is obsolete the instant it emerges from the printer. Indeed, in today's Internet time, it is obsolete before it goes into the printer! The pace of technological and information-age change, and the dynamism of the global marketplace, shorted the already brief life expectancy of any business plan. It is nearly impossible to find a year-old venture today that is identical in strategy, market focus, products or services, and team as it was described in its original business plan.

Work in Progress—Bent Knees Required

In such a rapidly changing environment, flexibility and responsiveness become critical survival skills. The process of developing an idea into a business, and articulating how this will be done via a business plan, requires an open mind and "bent knees," along with clear focus, commitment, and determination.

The business plan can be thought of as a work in progress. Though it must be completed, if you are trying to raise outside capital, attract key advisors, directors, or team members, and the like, it can never be completed. Like a cross-country flight plan, many unexpected changes can occur along the way—a thunderstorm, smoke impaired visibility, fog, or new powerful winds pop up. One has to be prepared to continually adjust course to minimize risk and ensure successful completion of the journey. Such risk/reward management is inherent in the business planning process.

The Plan Is Not the Business

Developing the business plan is one of the best ways to define the blueprint, strategy, resource, and people requirements for a new venture. The vast majority of *INC.*'s 500 fastest growing companies had business plans at the outset. Without a business plan it is exceedingly difficult to raise capital from informal or formal investors.

Yet, all too often first time entrepreneurs jump to a simplistic conclusion: All that is needed is a fat, polished, and enticing business plan and the business will automatically be successful. They confuse the plan and building the business. Paradoxically, some of the most impressive business plans never become great businesses. And some of the weakest plans lead to extraordinary businesses. Such was the case with Lotus Development Corporation, creator of the leading 1-2-3 spreadsheet. Mitch Kapor's original business plan was a brief letter, some descriptions of the personal computer market, a description of nearly 10 separate products, a one-year monthly startup budget, and a five-year goal of $30 million in revenue, which would require about $200–$300 thousand of capital. Venture capital backers Sevin–Rosen basically discarded the entire plan, the strategy, the product mix, the capital requirements, the launch plan, and the vision for the venture's first five years. They concluded the opportunity was much bigger, that $1 million of startup capital was required, that the company would either be several hundred million in revenue in five years, or would not be in business, even at $30 million in sales. The first-mover advantage of a warp-speed launch strategy was vital, and the rocket needed to be lit. The rest is history. Lotus Development reached $500 million in revenue in the first five years.

The message here is two-edged. The odds can be shaped in your favor through the development of a business plan. But, just because you have a plan does not mean the business will be an automatic success. Unless, the fundamental opportunity is there, along with the requisite resources and team needed to pursue it, the best plan in the world won't make much difference. Some helpful tips in preparing a business plan are summarized in *Exhibit 11.1*.

Some Tips from the Trenches

The most valuable lessons about preparing a business plan and raising venture capital come from entrepreneurs who have succeeded in these endeavors. Tom Huseby[1] is founder and head of SeaPoint Ventures outside Seattle, a venture capital firm allied with Venrock Venture Capital, Oak Venture Partners, and Sevin–Rosen Venture Partners. An engineering graduate of Columbia University and a Stanford MBA, Huseby spent 18 years with Raychem Corporation of California, first working in sales and eventually developing and managing new businesses, then running Raychem's businesses in several countries. Tom is a remarkable entrepreneur who has raised over $80 million of venture capital as CEO of two telecommunications startup companies in the early and mid-1990s that subsequently became publicly traded companies: Innova Corporation (NASDAQ: INNV) and Metawave Corporation (NASDAQ: MWAV). Consider the following wisdom Tom gleaned from his own experience on both sides of the negotiating table: entrepreneur/CEO and venture capitalist:

RE: Venture Capitalists—

- There are a lot of venture capitalists. Once you meet one you could end up meeting all 700+ of them.
- Getting a "no" from venture capitalists is as hard as getting a yes; qualify your targets and force others to say no.
- Be vague about what other venture capitalists you are talking to.
- Don't ever meet with an associate or junior member twice without a partner.

RE: The Plan—

- Stress your business concept in the executive summary.
- The numbers don't matter; but the economics (e.g., value proposition and business model) really matter.
- Make the business plan look and feel good; don't use any filler—you'll need it later.
- Prepare lots of copies of published articles, contracts, market studies, purchase orders, and the like.
- Prepare very detailed resumés and reference lists of key players in the venture.
- If you can't do the details, make sure you hire someone who can.

RE: The Deal—

- Make sure your current investors are as desperate as you are.
- Create a market for your venture.
- Never say no to an offer price.
- Use a lawyer who has closed lots of venture deals.
- Don't stop selling until the money is in the bank.
- Make it a challenge—never lie.

RE: The Fund Raising Process—

- It is much harder than you ever thought it could be.
- You can last much longer than you ever thought you could.
- The venture capitalists have to do this for the rest of their lives!

This is particularly valuable advice for any entrepreneur seeking outside capital and anticipating dealing with investors.[2]

Sell, Sell, Sell! Myopia

One of the most frequently missed opportunities in the entire process of developing a business plan and trying to convince outside investors to part with their cash is a consequence of sell-sell-sell! myopia by the founders. Obviously, the founder(s) will rarely if ever succeed in raising money or growing the business if she or he is not effective at selling. Selling ability is one of the most common denominators among successful entrepreneurs.

All too often, however, entrepreneurs—typically out of cash, or nearly so—become so obsessed with selling to prospective investors that they fail to ask great questions and do little serious listening. As a result, these founders learn very little from these prospects, even though they probably know a great deal about the technology, market, and competitors. After all, *that* is the investor's business.

Entrepreneurs who not only succeed at developing a great business concept but also attract the right investors who can add a great deal of value to the venture through their experience, wisdom, and

[1] The author is extremely grateful to Tom Huseby, a long-time friend, fellow fly fisherman, and wilderness explorer, for sharing his extraordinary wit and insights over the years in my classes at Babson College, Harvard Business School, and with the Kauffman Fellows Program, and for his contribution here.

[2] See "How to Write a Great Business Plan," William A. Sahlman, *Harvard Business Review*, July–August, 1997, pp. 98–108, for an excellent recent article on business plans.

networks, are usually very savvy listeners. They use the opportunity, beyond presenting their plan and selling themselves, to carefully query prospective investors: You've seen our concept, our story and our strategies, what have we missed? Where are we vulnerable? How would you knock us off? Who will knock us off? How would you modify our strategy? What would you do differently? Who do we need with us to make this succeed? What do you believe has to happen to make this highly successful? Be as blunt as you wish.

Two powerful forces are unleashed in this process. First, as a founder, you will begin to discern just how smart, knowledgeable, and, most importantly, creative the investors are about the proposed business. Do they have creative ideas, insights, and alternative ways of thinking about the opportunity and strategy that you and your team may not have thought of? This enables you, the founder, to ascertain just what value the investors might add to the venture and whether their approach to telling you and your team that you are "all wet" on certain things is acceptable. Would the relationship be likely to wear you out over time and demoralize you? In the process you will learn a great deal about your plan and the investors.

The second powerful force is the message implicitly sent to the investors when you make such genuine queries and listen, rather than become argumentative and defensive (which they may try to get you to do): We have given this our best shot. We are highly committed to our concept and believe we have the right strategy, but our minds are open. We listen, we learn, we have bent knees; we adapt and change when the evidence and ideas are compelling; we are not granite heads. Investors are much more likely to conclude that you are a founder and a team that they can work with.

The Dehydrated Business Plan

A dehydrated business plan usually runs from 4 to 10 pages, but rarely more. It covers key points, such as those suggested for the executive summary in the

EXHIBIT 11.1

Do's and Don'ts

Do

Do involve all of the management team in the preparation of the business plan.

Do make the plan logical, comprehensive, and *readable*—and as short as possible.

Do demonstrate commitment to the venture by investing a significant amount of time and some money in preparing the plan.

Do articulate what the critical risks and assumptions are and how and why these are tolerable.

Do disclose and discuss any current or potential problems in the venture.

Do identify several alternative sources of financing.

Do spell out the proposed deal—how much for what ownership share—and how investors will win.

Do be creative in gaining the attention and interest of potential investors.

Do remember that the plan is not the business and that an ounce of can-do implementation is worth two pounds of planning.

Do accept orders and customers that will generate a positive cash flow, even if it means you have to postpone writing the plan.

Do know your targeted investor group (e.g., venture capitalist, angel, bank, or leasing company) and what they really want and what they dislike, and tailor your plan accordingly.

Do let realistic market and sales projections drive the assumptions underlying the financial spreadsheets, rather than the reverse.

Don't

Don't have unnamed, mysterious people on the management team (e.g., a "Mr. G" who is currently a financial vice president with another firm and who will join you later).

Don't make ambiguous, vague, or unsubstantiated statements, such as estimating sales on the basis of what the team would like to produce.

Don't describe technical products or manufacturing processes using jargon or in a way that only an expert can understand, because this limits the usefulness of the plan. For example, a venture capitalist will not invest in what he or she does not understand—or what he or she thinks the team does not understand—because it cannot explain these to such a smart person as he or she is.

Don't spend money on developing fancy brochures, elaborate slide show presentations, and other "sizzle"—instead, show the "steak."

Don't waste time writing a plan when you could be closing sales and collecting cash.

Don't assume you have a done deal when you have a handshake or verbal commitment but no money in the bank. (The deal is done when the check clears!)

Business Planning Guide that follows. Essentially, such a plan documents the analysis of and information about the heart of the business opportunity, competitive advantages the company will enjoy, and *creative insights* that an entrepreneur often has.

Since it can usually be prepared in a few hours, it is preferred by entrepreneurs who find it difficult to find enough slack time while operating a business to write a complete plan. In many instances investors prefer a dehydrated plan in the initial screening phase.

It is important to note that such a plan is not intended to be used exclusively in the process of raising or borrowing money, and it is not useful in guiding the operations of a business over time.

Who Develops the Business Plan

Consideration often is given to hiring an outside professional to prepare the business plan, so the management team can use its time to obtain financing and start the business.

There are two good reasons why it is *not* a good idea to hire outside professionals. First, in the process of planning and of writing the business plan, the consequences of different strategies and tactics and the human and financial requirements for launching and building the venture can be examined, before it is too late. For example, one entrepreneur discovered, while preparing his business plan, that the major market for his biomedical product was in nursing homes, rather than in hospital emergency rooms, as he and his physician partner had previously assumed. This realization changed the focus of the entire marketing effort. Had he left the preparation to an outsider, this might not have been discovered, or, at the very least, it is unlikely he would have had the same sense of confidence and commitment to the new strategy.

A Closer Look at the What

The Relationship between Goals and Actions

Consider a team that is enthusiastic about an idea for a new business and has done a considerable amount of thinking and initial work evaluating the opportunity (such as thoroughly working through the Venture Opportunity Screening Guide in Chapter 4). Team members believe the business they are considering has excellent market prospects and fits well with the skills, experience, personal goals and values, and aspirations of its lead entrepreneur and the management team. They now need to ask about the most significant risks and problems involved in launching the enterprise, the long-term profit prospects, and the future financing and cash flow requirements. They must also ask about the demands of operating lead times, seasonality, and facility location, as well as about marketing and pricing strategy needs, and so forth, so they can take action.

These questions now need to be answered convincingly and the evidence for them shown *in writing*. The planning and the development of such a business plan is neither quick nor easy. In fact, effective planning is a difficult and demanding process and demands time, discipline, commitment and dedication, and practice. However, it also can be stimulating and fun as innovative solutions and strategies to solve nagging problems are found.

The skills to write a business plan are not necessarily the ones needed to make a venture successful (although some of these skills are certainly useful). The best single point of departure for, and an anchor during, the planning process is the motto on a small plaque in the office of Paul J. Tobin, president of Cellular One, a company that was a pioneer in the cellular car phone business in America. The motto says CAN DO, and is an apt one for planning and for making sure that a plan serves the very practical purpose for which it is intended.

Further, if a venture intends to use the business plan to raise capital, it is important for the team to do the planning and write the plan itself. Investors attach great importance to the quality of the management team *and* to their complete understanding of the business they are preparing to enter. Thus, investors want to be sure that what they see is what they get—that is, the team's analysis and understanding of the venture opportunity and its commitment to it. They are going to invest in a team and a leader, not in a consultant. Nothing less will do, and anything less is usually obvious.

Segmenting and Integrating Information

In the task of planning and writing a business plan, it is necessary to organize information in a way that it can be managed and that is useful.

An effective way to organize information with the idea of developing a business plan is to segment the information into sections, such as one about the target market, a section about the industry, one about competition, one about the financial plan, and so on, and then integrate the information into a business plan.

This process works best if sections are discrete and the information within them digestible. Then the order in which sections are developed can vary, and different sections can be developed simultaneously. For example, since the heart and soul of a plan lies in the analysis of the market opportunity, of the competition, and of a resultant competitive strategy that can win, it is a good idea to start with these sections and integrate information along the way. Since the financial and operations aspects of the venture will be driven by the rate of growth and the magnitude and specific substance of the market revenue plans, these can be developed later.

The information is then further integrated into the business plan. For example, the executive summary is prepared last.

Establishing Action Steps

The following steps, centered around actions to be taken, outline the process by which a business plan is written. Note these action steps are then presented in an exercise, "The Business Plan Guide."

- Segmenting information. An overall plan for the project, by section, needs to be devised and needs to include priorities, who is responsible for each section, the due date of a first draft, and the due date of a final draft.
- *Creating an overall schedule.* A list of specific tasks, their priorities, who is responsible for them, when they will be started, and when they will be completed needs to be made. This list needs to be as specific and detailed as possible. Tasks need to be broken down into the smallest possible component (e.g., a series of phone calls may be necessary before a trip). The list then needs to be examined for conflicts and lack of reality in time estimates. Peers and business associates can be asked to review the list for realism, timing, and priorities.
- *Creating an action calendar.* Tasks on the *do* list then need to be placed on a calendar. When the calendar is complete, the calendar needs again to be examined for conflicts or lack of realism.
- *Doing the work and writing the plan.* The necessary work needs to be done and the plan written. Adjustments need to be made to the *do* list and the calendar, as necessary. As part of this process, it is important to have a plan reviewed by an attorney to make sure that it contains no misleading statements and unnecessary information and caveats, and also reviewed by an objective outsider, such as an entrepreneurially minded executive who has significant profit and loss responsibility, or a venture capitalist who would not be a potential investor. No matter how good the lead entrepreneur and his or her team are in planning, there will be issues that they will overlook and certain aspects of the presentation that are inadequate or less than clear. Few entrepreneurs are good at both planning and communication. A good reviewer also can act as a sounding board in the process of developing alternative solutions to problems and answers to questions investors are likely to ask.

Preparing a Business Plan

A Complete Business Plan

It may seem to an entrepreneur who has completed the Opportunity Screening Guide in Chapter 4 and who has spent hours of thinking and planning informally that all that now needs to be done is to jot down a few things. *However, there is a great difference between screening an opportunity and developing a business plan.*

There are two important differences in the way these issues need to be addressed. First, a business plan can have two uses: (1) inducing someone to part with maybe $500,000 to $2 million, or even more, and (2) guiding the policies and actions of the firm over a number of years. Therefore, strategies and statements made need to be well thought out, unambiguous, and capable of being supported.

Another difference is that more detail is needed. (The exception to this is the "Dehydrated Business Plan" discussed earlier in this chapter.) This means that the team needs to spend more time gathering detailed data, interpreting it, and presenting it clearly. For example, for the purpose of screening an opportunity, it may be all right to note (if one cannot do any better) that the target market for a product is in the $30–$60 million range and the market is growing over 10 percent per year. For purposes of planning to launch an actual new enterprise, determining strategy, and so forth, this level of detail would not get by. The size range would need to be narrowed considerably; if it were not narrowed, those reading or using the plan would have little confidence in this critical number. And saying the target market is growing at over 10 percent is too vague. Does that mean the market grew at the stated rate between last year and the year before, or does it mean that the market grew on average by this amount over the past three years? Also, a statement phrased in terms of "over 10 percent" smacks of imprecision. The actual growth rate needs to be known and needs to be stated. Whether the rate will or will not remain the same, and why, needs to be explained also.

Preparing an effective business plan for a startup can easily take 200 to 300 hours. Squeezing that amount of time into evenings and weekends can make the process stretch over 3 to 12 months.

A business plan for a business planning expansion or for a situation such as a leveraged buyout typically can take half this effort. The reason is that the knowns about the business, including the market, its competition, financial and accounting information, and so on, at this point are greater.

Exhibit 11.2 is a sample table of contents for a business plan. The information shown is included in most effective business plans. The way information is presented in this exhibit is a good framework to follow. First, organizing the material into sections makes dealing with the information more manageable. Second, while the amount of detail and the order of presentation may vary for a particular venture according to its particular circumstances, most effective business plans contain this information in some form. (Note that the amount of detail and the order in which information is presented is important. These can vary for each particular situation, and will depend upon the purpose of the plan and the age and stage of the venture, among other factors.)

Exercise—The Business Plan Guide

The Business Plan Guide follows the order of *presentation* outlined in *Exhibit 11.2.* Based on a guide originally developed at Venture Founders Corporation by Leonard E. Smollen and the late Brian Haslett, and on over 20 years of observing and working with entrepreneurs and actually preparing and evaluating hundreds of plans, it is intended to make this challenging task easier.

Certainly, there is no single best way to write a business plan, and there are many ways to approach the preparation for and writing of a business plan. It is recommended that you begin with the market research and analysis sections. In the final analysis, the task will evolve in a way that suits you and your situation.

In writing your plan, you should remember that although one of the important functions of a business plan is to influence investors, rather than preparing a fancy presentation, you and your team need to prove to yourselves and others that your opportunity is worth pursuing, and to construct the means by which you will do it. Gathering information, making hard decisions, and developing plans come first.

The plan guide that follows shows how to present information succinctly and in a format acceptable to investors. While it is useful to keep in mind who your audience is, and that information not clearly presented will most likely not be used, it also is important not to be concerned *just* with format.

In the Business Plan Guide, issues are indicated. The intent is to show you what needs to be included in a business plan and why.

Further, you may feel as though you have seen much of this before. You should. The guide is based on the analytical framework described in the book and builds upon the Opportunity Screening Guide in Chapter 4. If you have not completed the Opportunity Screening Guide, it will help you to do so before proceeding. It is assumed in the Business Plan Guide that you will be able to draw on data and analysis developed in the Opportunity Screening Guide to help you prepare your business plan.

As you proceed through the Business Plan Guide, remember that statements need to be supported with data where possible. Note also that it is sometimes easier to present data in tabular form. Include the source of all data, the methods and/or assumptions used, and the credentials of people doing research. If data on which a statement is based is available elsewhere in the plan, be sure to indicate where it can be found.

Finally, it is important to remember that the Business Plan Guide is just that—a guide. It is intended to be applicable to a wide range of product and service businesses. For any particular industry or market, certain critical issues are unique to that industry or market. In the chemical industry, for example, some special issues of significance currently exist, such as increasingly strict regulations at all levels of government covering the use of chemical products and the operation of processes, diminishing viability of the high-capital-cost, special-purpose chemical processing plants serving a narrow market, and long delivery times of processing equipment. In the electronics industry, the special issues may be the future availability and price of new kinds of large-scale integrated circuits.

Common sense should rule in applying the guide to your specific venture.

EXHIBIT 11.2

Business Plan

Table of Contents

Table of Contents

Included in the table of contents is a list of the sections, any appendices, and any other information and the pages on which they can be found. (See *Exhibit 11.2.*)

I. Executive Summary

The first section in the body of the business plan is usually an executive summary. The summary is usually short and concise (one or two pages). The summary articulates what the opportunity conditions are and why they exist, who will execute the opportunity and why they are capable of doing so, how the firm will gain entry and market penetration, and so on. Essentially, the summary for your venture needs to mirror the criteria shown in *Exhibit 3.5* and the Venture Opportunity Screening Guide.

The summary is usually prepared after the other sections of the business plan are completed. It is therefore helpful, as the other sections are drafted, to note one or two key sentences, and some key facts and numbers from each.

The summary is important for those ventures trying to raise or borrow money. Many investors, bankers, managers, and other readers use the summary to determine quickly whether the venture the plan describes is of interest. Therefore, unless the summary is appealing and compelling, it may be the only section read, and you may never get the chance to make a presentation or discuss your business in person.

Therefore, leave plenty of time to prepare the summary. (Successful public speakers have been known to spend an hour of preparation for each minute of their speech.)

The executive summary usually contains a paragraph or two covering each of the following:

A. *Description of the business concept and the business.* Describe the business concept for the business you are or will be in. For example, Outdoor Scene, Inc. wanted to produce tents, but the concept was "to become a leader in providing quality, service, and on-time delivery in outdoor leisure products." Be sure the description of your concept explains how your product or service will fundamentally change the way customers currently do certain things. For example, Arthur Rock, the lead investor in Apple Computer and Intel, has stated that he focuses on concepts that will change the way people live and/or work. You need to identify when the company was formed, what it will do, what is special or proprietary about its product, service, or technology, and so forth. Include summary information about any proprietary technology, trade secrets, or unique capabilities that give you an edge in the marketplace. If the company has existed for a few years, a brief summary of its size and progress is in order. Try to make your description 25 words or less, and mention the specific product or service.

B. *The opportunity and strategy.* Summarize what the opportunity is, why it is compelling, and the entry strategy planned to exploit it. This information may be presented as an outline of the key facts, conditions, competitors' vulnerabilities ("sleepiness," sluggishness, poor service, etc.), industry trends, and other evidence and logic that define the opportunity. Note plans for growth and expansion beyond the entry products or services and into other market segments (such as international markets) as appropriate.

C. *The target market and projections.* Identify and briefly explain the industry and market, who the primary customer groups are, how the product(s) or service(s) will be positioned, and how you plan to reach and service these groups. Include information about the structure of the market, the size and growth rate for the market segments or niches you are seeking, your unit and dollar sales estimates, your anticipated market share, the payback period for your customers, and your pricing strategy (including price versus performance/value/benefits considerations).

D. *The competitive advantages.* Indicate the significant competitive edges you enjoy or can create as a result of your innovative product, service, and strategy; advantages in lead time; competitors' weaknesses and vulnerabilities; and other industry conditions.

E. *The economics, profitability, and harvest potential.* Summarize the nature of the "forgiving and rewarding" economics of the venture (e.g., gross and operating margins, expected profitability and durability of those profits); the relevant time frames to attain break-even and positive cash flow; key financial projections; the expected return on investment; and so on. Be sure to include a brief discussion of your contribution analysis and the underlying operating and cash conversion cycle. Use key numbers whenever possible.

F. *The team.* Summarize the relevant knowledge, experience, know-how, and skills of the lead entrepreneur and any team members, noting previous accomplishments, especially those involving profit and loss responsibility and general management and people management experience. Include significant information, such as the size of a division, project, or prior business with which the lead entrepreneur or a team member was the driving force.

G. *The offering.* Briefly indicate the dollar amount of equity and/or debt financing needed, how much of the company you are prepared to offer for that financing, what principal use will be made of the capital, and how the targeted investor, lender, or strategic partner will achieve its desired rate of return.

II. The Industry and the Company and Its Product(s) or Service(s)

A major area of consideration is the company, its concept for its product(s) and service(s), and its interface with the industry in which it will be competing. This is the context into which the marketing information, for example, fits. Information needs to include a description of the industry, a description of the concept, a description of your company, and a description of the product(s) or service(s) you will offer, the proprietary position of these product(s) or service(s), their potential advantages, and entry and growth strategy for the product(s) or service(s).

A. *The industry:*

— Present the current status and prospects for the industry in which the proposed business will operate. Be sure to consider industry structure.

— Discuss briefly market size, growth trends, and competitors.

— Discuss any new products or developments, new markets and customers, new requirements, new entrants and exits, and any other national or economic trends and factors that could affect the venture's business positively or negatively.

B. *The company and the concept:*

— Describe generally the concept of the business, what business your company is in or intends to enter, what product(s) or service(s) it will offer, and who are or will be its principal customers.

— By way of background, give the date your venture was incorporated and describe the identification and development of its products and the involvement of the company's principals in that development.

— If your company has been in business for several years and is seeking expansion financing, review its history and cite its prior sales and profit performance, and if your company has had setbacks or losses in prior years, discuss these and emphasize current and future efforts to prevent a recurrence of these difficulties and to improve your company's performance.

C. *The product(s) or service(s):*

— Describe in some detail each product or service to be sold.

— Discuss the application of the product or service and describe the primary end use as well as any significant secondary applications.

— Emphasize any unique features of the product or service and how these will create or add significant value; also, highlight any differences between what is currently on the market and what you will offer that will account for your market penetration. Be sure to describe how value will be added and the payback period to the customer—that is, discuss how many months it will take for the customer to cover the initial purchase price of the product or service as a result of its time, cost, or productivity improvements.

— Include a description of any possible drawbacks (including problems with obsolescence) of the product or service.

— Define the present state of development of the product or service and how much time and money will be required to fully develop, test, and introduce the product or service. Provide a summary of the functional specifications and photographs, if available, of the product.

— Discuss any head start you might have that would enable you to achieve a favored or entrenched position in the industry.

— Describe any features of the product or service that give it an "unfair" advantage over the competition. Describe any patents, trade secrets, or other proprietary features of the product or service.

— Discuss any opportunities for the expansion of the product line or the development of related products or services. (Emphasize opportunities and explain how you will take advantage of them.)

D. *Entry and growth strategy:*

— Indicate key success variables in your marketing plan (e.g., an innovative product, timing advantage, or marketing approach) and your pricing, distribution, advertising, and promotion plans.

— Summarize how fast you intend to grow and to what size during the first five years and your plans for growth beyond your initial product or service.

— Show how the entry and growth strategy is derived from the opportunity and value-added or other competitive advantages, such as the weakness of competitors.

III. Market Research and Analysis

Because of the importance of market analysis and the critical dependence of other parts of the plan on this information, you are advised to prepare this section of the business plan before any other. Take enough time to do this section very well and to check alternative sources of market data.

Information in this section needs to support the assertion that the venture can capture a substantial market in a growing industry in the face of competition.

This section of the business plan is one of the most difficult to prepare, yet it is one of the most important. Other sections of the business plan depend on the market research and analysis presented here. For example, the predicted sales levels directly influence such factors as the size of the manufacturing operation, the marketing plan, and the amount of debt and equity capital you will require. Yet most entrepreneurs seem to have great difficulty preparing and presenting market research and analyses that show that their ventures' sales estimates are sound and attainable.

A. *Customers:*

— Discuss who the customers for the product(s) or service(s) are or will be. Note that potential customers need to be classified by relatively homogeneous groups having common, identifiable characteristics (e.g., by major market segment). For example, an automotive part might be sold to manufacturers and to parts distributors supplying the replacement market, so the discussion needs to reflect two market segments.

— Show who and where the major purchasers for the product(s) or service(s) are in each market segment. Include regional and foreign countries, as appropriate.

— Indicate whether customers are easily reached and receptive, how customers buy (wholesale, through manufacturers' representatives, etc.), where in their organizations such buying decisions are made, and how long such decisions take. Describe customers' purchasing processes, including the bases on which they make purchase decisions (e.g., price, quality, timing, delivery, training, service, personal contacts, or political pressures) and why they might change current purchasing decisions.

— List any orders, contracts, or letters of commitment that you have in hand. These are far and away *the most powerful data* you can provide. List also any potential customers who have expressed an interest in the product(s) or service(s) and indicate why; also list any potential customers who have shown no interest in the proposed product or service and explain why they are not interested and explain what you will do to overcome negative customer reaction. Indicate how fast you believe your product or service will be accepted in the market.

— If you have an existing business, list your principal current customers and discuss the trends in your sales to them.

B. *Market size and trends:*

— Show for five years the size of the current total market and the share you will have, by market segment and/or by region and/or country, for the product or service you will offer, in units, dollars, and potential profitability.

— Describe also the potential annual growth for at least three years of the total market for your product(s) or service(s) for each major customer group, region, or country, as appropriate.

— Discuss the major factors affecting market growth (e.g., industry trends, socioeconomic trends, government policy, and population shifts) and review previous trends in the market. Any differences between past and projected annual growth rates need to be explained.

C. *Competition and competitive edges:*

— Make a realistic assessment of the strengths and weaknesses of competitors. Assess the substitute and/or alternative products and services and list the companies that supply them, both domestic and foreign, as appropriate.

— Compare competing and substitute products or services on the basis of market share, quality, price, performance, delivery, timing, service, warranties, and other pertinent features.

— Compare the fundamental value that is added or created by your product or service, in terms of economic benefits to the customer and to your competitors.

— Discuss the current advantages and disadvantages of these products and services and say why they are not meeting customer needs.

— Indicate any knowledge of competitors' actions that could lead you to new or improved products and an advantageous position. For example, discuss whether competitors are simply sluggish or nonresponsive or are asleep at the switch.

— Review the strengths and weaknesses of the competing companies and determine and discuss the share of the market of each competitor, its sales, its distribution methods, and its production capabilities.

— Review also the financial position, resources, costs, and profitability of the competition and their profit trend. Note that you can utilize Robert Morris Associates data for comparison (see Appendix I on this book's Web site).

— Indicate who are the service, pricing, performance, cost, and quality leaders. Discuss why any companies have entered or dropped out of the market in recent years.

— Discuss the three or four key competitors and why customers buy from them, and determine and discuss why customers *leave* them.

— From what you know about the competitors' operations, explain why you think that they are vulnerable and you can capture a share of their business. Discuss what makes you think it will be easy or difficult to compete with them. Discuss, in particular, your competitive advantages gained through such "unfair" advantage as patents.

D. *Estimated market share and sales:*

— Summarize what it is about your product(s) or service(s) that will make it saleable in the face of current and potential competition. Mention, especially, the fundamental value added or created by the product(s) or service(s).

— Identify any major customers (including international customers) who are willing to make, or who have already made, purchase commitments, and indicate the extent of those commitments and why they were made, and discuss which customers could be major purchasers in future years and why.

— Based on your assessment of the advantages of your product or service, the market size and trends, customers, the competition and their products, and the trends of sales in prior years, estimate the share of the market and the sales in units and dollars that you will acquire in each of the next three years. Remember to show assumptions used.

— Show how the growth of the company sales in units and its estimated market share are related to the growth of its industry and customers and the strengths and weaknesses of competitors. Remember, the assumptions used to estimate market share and sales need to be clearly stated.

— If yours is an existing business, also indicate the total market, your market share, and sales for two prior years.

E. *Ongoing market evaluation:*

— Explain how you will continue to evaluate your target markets so as to assess customer needs and service and to guide product-improvement programs and new-product programs, plan for expansions of your production facility, and guide product/service pricing.

IV. The Economics of the Business

The economic and financial characteristics, including the apparent magnitude and durability of margins and profits generated, need to support the fundamental attractiveness of the opportunity. The underlying operating and cash conversion cycle of the business, the value chain, and so forth, need to make sense in terms of the opportunity and strategies planned.

A. *Gross and operating margins:*

— Describe the magnitude of the gross margins (i.e., selling price less variable costs) and the operating margins for each of the product(s) and/or service(s) you are selling in the market niche(s) you plan to attack. Include results of your contribution analysis.

B. *Profit potential and durability:*

— Describe the magnitude and expected durability of the profit stream the business will generate—before and after taxes—and reference appropriate industry benchmarks, other competitive intelligence, or your own relevant experience.

— Address the issue of how perishable or durable the profit stream appears to be. Provide reasons why your profit stream is perishable or durable, such as barriers to entry you can create, your technological and market lead time, and so on.

C. *Fixed, variable, and semivariable costs:*

— Provide a detailed summary of fixed, variable, and semivariable costs, in dollars and as percentages of total cost as appropriate, for the product or service you offer and the volume of purchases and sales upon which these are based.

— Show relevant industry benchmarks.

D. *Months to breakeven:*

— Given your entry strategy, marketing plan, and proposed financing, show how long it will take to reach a unit breakeven sales level.

— Note any significant stepwise changes in your breakeven that will occur as you grow and add substantial capacity.

E. *Months to reach positive cash flow:*

— Given the above strategy and assumptions, show when the venture will attain a positive cash flow.

— Show if and when you will run out of cash. Note where the detailed assumptions can be found.

— Note any significant stepwise changes in cash flow that will occur as you grow and add capacity.

V. Marketing Plan

The marketing plan describes how the sales projections will be attained. The marketing plan needs to detail the overall marketing strategy that will exploit the opportunity and your competitive advantages. Include a discussion of sales and service policies; pricing, distribution, promotion, and advertising strategies; and sales projections. The marketing plan needs to describe *what* is to be done, *how* it will be done, *when* it will be done, and *who* will do it.

A. *Overall marketing strategy:*

— Describe the specific marketing philosophy and strategy of the company, given the value chain and channels of distribution in the market niche(s) you are pursuing. Include, for example, a discussion of the kinds of customer groups that you already have orders from or that will be targeted for initial intensive selling effort and those targeted for later selling efforts; how specific potential customers in these groups will be identified and how will they be contacted; what features of the product or service, such as service, quality, price, delivery, warranty, or training, will be emphasized to generate sales; if any innovative or unusual marketing concepts will enhance customer acceptance, such as leasing where only sales were previously attempted; and so forth.

— Indicate whether the product(s) or service(s) will initially be introduced internationally, nationally, or regionally; explain why; and if appropriate, indicate any plans for extending sales at a later date.

— Discuss any seasonal trends that underlie the cash conversion cycle in the industry and what can be done to promote sales out of season.

— Describe any plans to obtain government contracts as a means of supporting product development costs and overhead.

B. *Pricing:*

— Discuss pricing strategy, including the prices to be charged for your product and service, and compare your pricing policy with those of your major competitors, including a brief discussion of payback (in months) to the customer.

— Discuss the gross profit margin between manufacturing and ultimate sales costs and indicate whether this margin is large enough to allow for distribution and sales, warranty, training, service, amortization of development and equipment costs, price competition, and so forth—and still allow a profit.

— Explain how the price you set will enable you (1) to get the product or service accepted, (2) to maintain and increase your market share in the face of competition, and (3) to produce profits.

— Justify your pricing strategy and differences between your prices and those for competitive or substitute products or services in terms of economic payback to the customer and value added through newness, quality, warranty, timing, performance, service, cost savings, efficiency, and the like.

— If your product is to be priced lower than those of the competition, explain how you will do this and maintain profitability (e.g., through greater value added via effectiveness in manufacturing and distribution, lower labor costs, lower material costs, lower overhead, or other component of cost).

— Discuss your pricing policy, including a discussion of the relationship of price, market share, and profits.

For example, a higher price may reduce volume but result in a higher gross profit.

— Describe any discount allowance for prompt payment or volume purchases.

C. *Sales tactics:*

— Describe the methods (e.g., own sales force, sales representatives, ready-made manufacturers' sales organizations, direct mail, or distributors) that will be used to make sales and distribute the product or service and both the initial plans and longer-range plans for a sales force. Include a discussion of any special requirements (e.g., refrigeration).

— Discuss the value chain and the resulting margins to be given to retailers, distributors, wholesalers, and salespeople and any special policies regarding discounts, exclusive distribution rights, and so on, given to distributors or sales representatives and compare these to those given by your competition. (See the Venture Opportunity Screening Guide.)

— Describe how distributors or sales representatives, if they are used, will be selected, when they will start to represent you, the areas they will cover and the build-up (a head count) of dealers and representatives by month, and the expected sales to be made by each.

— If a direct sales force is to be used, indicate how it will be structured and at what rate (a head count) it will be built up; indicate if it is to replace a dealer or representative organization and, if so, when and how.

— If direct mail, magazine, newspaper, or other media, telemarketing, or catalog sales are to be used, indicate the specific channels or vehicles, costs (per 1,000), and expected response rates and yield (as percentage) from the various media, and so on, used. Discuss how these will be built up.

— Show the sales expected per salesperson per year and what commission, incentive, and/or salary they are slated to receive, and compare these figures to the average for your industry.

— Present a selling schedule and a sales budget that includes all marketing promotion and service costs.

D. *Service and warranty policies:*

— If your company will offer a product that will require service, warranties, or training, indicate the importance of these to the customers' purchasing decisions and discuss your method of handling service problems.

— Describe the kind and term of any warranties to be offered, whether service will be handled by company servicepeople, agencies, dealers and distributors, or returns to the factory.

— Indicate the proposed charge for service calls and whether service will be a profitable or break-even operation.

— Compare your service, warranty, and customer training policies and practices to those of your principal competitors.

E. *Advertising and promotion:*

— Describe the approaches the company will use to bring its product or service to the attention of prospective purchasers.

— For original equipment manufacturers and for manufacturers of industrial products, indicate the plans for trade show participation, trade magazine advertisements, direct mailings, the preparation of product sheets and promotional literature, and use of advertising agencies.

— For consumer products, indicate what kind of advertising and promotional campaign is contemplated to introduce the product and what kind of sales aids will be provided to dealers, what trade shows, and so forth, are required.

— Present a schedule and approximate costs of promotion and advertising (direct mail, telemarketing, catalogs, etc.), and discuss how these costs will be incurred.

F. *Distribution:*

— Describe the methods and channels of distribution you will employ.

— Indicate how sensitive shipping cost is as a percent of the selling price.

— Note any special issues or problems that need to be resolved, or present potential vulnerabilities.

— If international sales are involved, note how these sales will be handled, including distribution, shipping, insurance, credit, and collections.

VI. Design and Development Plans

The nature and extent of any design and development work and the time and money required before a product or service is marketable need to be considered in detail. (Note that design and development costs are often underestimated.) Such design and development might be the engineering work necessary to convert a laboratory prototype to a finished product; the design of special tooling; the work of an industrial designer to make a product more attractive and salable; or the identification and organization of employees, equipment, and special techniques, such as the equipment, new computer software, and skills required for computerized credit checking, to implement a service business.

A. *Development status and tasks:*

— Describe the current status of each product or service and explain what remains to be done to make it marketable.

— Describe briefly the competence or expertise that your company has or will require to complete this development.

— List any customers or end users who are participating in the development, design, and/or testing of the product or service. Indicate results to date or when results are expected.

B. *Difficulties and risks:*

— Identify any major anticipated design and development problems and approaches to their solution.

— Discuss the possible effect on the cost of design and development, on the time to market introduction, and so forth, of such problems.

C. *Product improvement and new products:*

— In addition to describing the development of the initial products, discuss any ongoing design and development work that is planned to keep product(s) or service(s) competitive and to develop new related product(s) or service(s) that can be sold to the same group of customers. Discuss customers who have participated in these efforts and their reactions, and include any evidence that you may have.

D. *Costs:*

— Present and discuss the design and development budget, including costs of labor, materials, consulting fees, and so on.

— Discuss the impact on cash flow projections of underestimating this budget, including the impact of a 15 to 30 percent contingency.

E. *Proprietary issues:*

— Describe any patent, trademark, copyright, or intellectual property rights you own or are seeking.

— Describe any contractual rights or agreements that give you exclusivity or proprietary rights.

— Discuss the impact of any unresolved issues or existing or possible actions pending, such as disputed rights of ownership, relating to proprietary rights on timing and on any competitive edge you have assumed.

VII. Manufacturing and Operations Plan

The manufacturing and operations plan needs to include such factors as plant location, the type of facilities needed, space requirements, capital equipment requirements, and labor force (both full- and part-time) requirements. For a manufacturing business, the manufacturing and operations plan needs to include policies on inventory control, purchasing, production control, and which parts of the product will be purchased and which operations will be performed by your workforce (called make-or-buy decisions). A service business may require particular attention to location (proximity to customers is generally a must), minimizing overhead, and obtaining competitive productivity from a labor force.

A. *Operating cycle:*

— Describe the lead/lag times that characterize the fundamental operating cycle in your business. (Include a graph similar to the one found in the Venture Opportunity Screening Guide.)

— Explain how any seasonal production loads will be handled without severe dislocation (e.g., by building to inventory or using part-time help in peak periods).

B. *Geographical location:*

— Describe the planned geographical location of the business. Include any location analysis, and so on, that you have done.

— Discuss any advantages or disadvantages of the site location in terms of such factors as labor (including labor availability, whether workers are unionized, and wage rates), closeness to customers and/or suppliers, access to transportation, state and local taxes and laws (including zoning regulations), access to utilities, and so forth.

C. *Facilities and improvements:*

— For an existing business, describe the facilities, including plant and office space, storage and land areas, special tooling, machinery, and other capital equipment currently used to conduct the company's business, and discuss whether these facilities are adequate. Discuss any economies to scale.

— For a startup, describe how and when the necessary facilities to start production will be acquired.

— Discuss whether equipment and space will be leased or acquired (new or used) and indicate the costs and timing of such actions and how much of the proposed financing will be devoted to plant and equipment.

— Explain future equipment needs in the next three years.

— Discuss how and when, in the next three years, plant space and equipment will be expanded to the capacities required by future sales projections and any plans to improve or add to existing plant space or move the facility; indicate the timing and cost of such acquisitions.

D. *Strategy and plans:*

— Describe the manufacturing processes involved in production of your product(s) and any decisions with respect to subcontracting of component parts, rather than complete in-house manufacture.

— Justify your proposed make-or-buy policy in terms of inventory financing, available labor skills, and other nontechnical questions, as well as production, cost, and capability issues.

— Discuss who potential subcontractors and/or suppliers are likely to be and any information about, or any surveys which have been made of, these subcontractors and suppliers.

— Present a production plan that shows cost/volume information at various sales levels of operation with breakdowns of applicable material, labor, purchased components, and factory overhead, and that shows the inventory required at various sales levels.

— Describe your approach to quality control, production control, inventory control, and explain what quality control and inspection procedures the company will use to minimize service problems and associated customer dissatisfaction.

E. *Regulatory and legal issues:*

— Discuss here any relevant state, federal, or foreign regulatory requirements unique to your product, process, or service, such as laws or other regulatory compliance unique to your business and any licenses, zoning permits, health permits, environmental approvals, and the like, necessary to begin operation.

— Note any pending regulatory changes that can affect the nature of your opportunity and its timing.

— Discuss any legal or contractual obligations that are pertinent as well.

VIII. Management Team

This section of the business plan includes a description of the functions that will need to be filled, a description of the key management personnel and their primary duties, an outline of the organizational structure for the venture, a description of the board of directors, a description of the ownership position of any other investors, and so forth. You need to present indications of commitment, such as the willingness of team members to initially accept modest salaries, and of the existence of the proper balance of technical, managerial, and business skills and experience in doing what is proposed.

A. *Organization:*

— Present the key management roles in the company and the individuals who will fill each position. (If the company is established and of sufficient size, an organization chart needs to be appended.)

— If it is not possible to fill each executive role with a full-time person without adding excessive overhead, indicate how these functions will be performed (e.g., using part-time specialists or consultants to perform some functions), who will perform them, and when they will be replaced by a full-time staff member.

— If any key individuals will not be on board at the start of the venture, indicate when they will join the company.

— Discuss any current or past situations where key management people have worked together that could indicate how their skills complement each other and result in an effective management team.

B. *Key management personnel:*

— For each key person, describe in detail career highlights, particularly relevant know-how, skills, and track record of accomplishments, that demonstrate his or her ability to perform the assigned role. Include in your description sales and profitability achievements (budget size, numbers of subordinates, new product introductions, etc.) and other prior entrepreneurial or general management results.

— Describe the exact duties and responsibilities of each of the key members of the management team.

— Complete resumes for each key management member need to be included here or as an exhibit and need to stress relevant training, experience, and concrete accomplishments, such as profit and sales improvement, labor management success, manufacturing or technical achievements, and meeting of budgets and schedules.

C. *Management compensation and ownership:*

— State the salary to be paid, the stock ownership planned, and the amount of their equity investment (if any) of each key member of the management team.

— Compare the compensation of each key member to the salary he or she received at his or her last independent job.

D. *Other investors:*

— Describe here any other investors in your venture, the number and percentage of outstanding shares they own, when they were acquired, and at what price.

E. *Employment and other agreements and stock option and bonus plans:*

— Describe any existing or contemplated employment or other agreements with key members.

— Indicate any restrictions on stock and vesting that affect ownership and disposition of stock.

— Describe any performance-dependent stock option or bonus plans that are contemplated.

— Summarize any incentive stock option or other stock ownership plans planned or in effect for key people and employees.

F. *Board of directors:*

— Discuss the company's philosophy about the size and composition of the board.

— Identify any proposed board members and include a one- or two-sentence statement of the member's background that shows what he or she can bring to the company.

G. *Other shareholders, rights, and restrictions:*

— Indicate any other shareholders in your company and any rights and restrictions or obligations, such as notes or guarantees, associated with these. (If they have all been accounted for above, simply note that there are no others.)

H. *Supporting professional advisors and services:*

— Indicate the supporting services that will be required.

— Indicate the names and affiliations of the legal, accounting, advertising, consulting, and banking advisors selected for your venture and the services each will provide.

IX. Overall Schedule

A schedule that shows the timing and interrelationship of the major events necessary to launch the venture and realize its objectives is an essential part of a business plan. The underlying cash conversion and operating cycle of the business will provide key inputs for the schedule. In addition to being a planning aid, by showing deadlines critical to a venture's success, a well-presented schedule can be extremely valuable in convincing potential investors that the management team is able to plan for venture growth in a way that recognizes obstacles and minimizes investor risk. Since the time to do things tends to be underestimated in most business plans, it is important to demonstrate that you have correctly estimated these amounts in determining the schedule. Create your schedule as follows:

Step 1: Lay out (use a bar chart) the cash conversion cycle in the business to capture for each product or service expected the lead and elapsed times from an order to the purchase of raw materials or inventory to shipping and collection.

Step 2: Prepare a month-by-month schedule that shows the timing of such activities as product development, market planning, sales programs, production, and operations, and that includes sufficient detail to show the timing of the primary tasks required to accomplish an activity.

Step 3: Show on the schedule the deadlines or milestones critical to the venture's success, such as:

— Incorporation of the venture.
— Completion of design and development.
— Completion of prototypes.
— Obtaining of sales representatives.
— Obtaining product display at trade shows.
— Signing up of distributors and dealers.
— Ordering of materials in production quantities.
— Starting of production or operation.
— Receipt of first orders.
— Delivery on first sale.
— Receiving the first payment on accounts receivable.

Step 4: Show on the schedule the "ramp up" of the number of management personnel, the number of production and operations personnel, and plant or equipment and their relation to the development of the business.

Step 5: Discuss in a general way the activities most likely to cause a schedule slippage, what steps will be taken to correct such slippages, and the impact of schedule slippages on the venture's operation, especially its potential viability and capital needs.

X. Critical Risks, Problems, and Assumptions

The development of a business has risks and problems, and the business plan invariably contains some implicit assumptions about them. You need to include a description of the risks and the consequences of adverse outcomes relating to your industry, your company and its personnel, your product's market appeal, and the timing and financing of your startup. Be sure to discuss assumptions concerning sales projections, customer orders, and so forth. If the venture has anything that could be considered a fatal flaw, discuss why it is not. The discovery of any unstated negative factors by potential investors can undermine the credibility of the venture and endanger its financing. Be aware that most investors will read the section describing the management team first and then this section.

It is recommended that you *not omit* this section. If you do, the reader will most likely come to one or more of the following conclusions:

1. You think he or she is incredibly naive or stupid, or both.
2. You hope to pull the wool over his or her eyes.
3. You do not have enough objectivity to recognize and deal with assumptions and problems.

Identifying and discussing the risks in your venture demonstrate your skills as a manager and increase the credibility of you and your venture with a venture capital investor or a private investor. Taking the initiative on the identification and discussion of risks helps you to demonstrate to the investor that you have thought about them and can handle them. Risks then tend not to loom as large black clouds in the investor's thinking about your venture.

1. Discuss assumptions and risks implicit in your plan.
2. Identify and discuss any major problems and other risks, such as:
   — Running out of cash *before* orders are secured.
   — Potential price cutting by competitors.
   — Any potentially unfavorable industrywide trends.
   — Design or manufacturing costs in excess of estimates.
   — Sales projections not achieved.
   — An unmet product development schedule.
   — Difficulties or long lead times encountered in the procurement of parts or raw materials.
   — Difficulties encountered in obtaining needed bank credit.
   — Larger-than-expected innovation and development costs.
   — Running out of cash *after* orders pour in.
3. Indicate what assumptions or potential problems and risks are most critical to the success of the venture, and describe your plans for minimizing the impact of unfavorable developments in each case.

XI. The Financial Plan

The financial plan is basic to the evaluation of an investment opportunity and needs to represent your best estimates of financial requirements. The purpose of the financial plan is to indicate the venture's potential and to present a timetable for financial viability. It also can serve as an operating plan for financial management using financial benchmarks. In preparing the financial plan, you need to look creatively at your venture and consider alternative ways of launching or financing it.

As part of the financial plan, financial exhibits need to be prepared. To estimate *cash flow needs,* use cash-based, rather than an accrual-based, accounting (i.e., use a real-time cash flow analysis of expected receipts and disbursements). This analysis needs to cover three years. Included also are current- and prior-year income statements and balance sheets, if applicable; profit and loss forecasts for three years; pro forma income statements and balance sheets; and a break-even chart. On the appropriate exhibits, or in an attachment, assumptions behind such items as sales levels and growth, collections and payables periods, inventory requirements, cash balances, cost of goods, and so forth, need to be specified. Your analysis of the operating and cash conversion cycle in the business will enable you to identify these critical assumptions.

Pro forma income statements are the plan-for-profit part of financial management and can indicate the potential financial feasibility of a new venture. Since usually the level of profits, particularly during the start-up years of a venture, will not be sufficient to finance operating asset needs, and since actual cash inflows do not always match the actual cash outflows on a short-term basis, a cash flow forecast that will indicate these conditions and enable management to plan cash needs is recommended. Further, pro forma balance sheets are used to detail the assets required to support the projected level of operations and, through liabilities, to show how these assets are to be financed. The projected balance sheets can indicate if debt-to-equity ratios, working capital, current ratios, inventory turnover, and the like are within the acceptable limits required to justify future financings that are projected for the venture. Finally, a break-even chart showing the level of sales and production that will cover all costs, including those costs that vary with production level and those that do not, is very useful.

A. *Actual income statements and balance sheets:* For an existing business, prepare income statements and balance sheets for the current year and for the prior two years.

B. *Pro forma income statements:*

— Using sales forecasts and the accompanying production or operations costs, prepare pro forma income statements for at least the first three years.

— Fully discuss assumptions (e.g., the amount allowed for bad debts and discounts, or any assumptions made with respect to sales expenses or general and administrative costs being a fixed percentage of costs or sales) made in preparing the pro forma income statement and document them.

— Draw on Section X of the business plan and highlight any major risks, such as the effect of a 20 percent reduction in sales from those projected or the adverse impact of having to climb a learning curve on the level of productivity over time, that could prevent the venture's sales and profit goals from being attained, plus the sensitivity of profits to these risks.

C. *Pro forma balance sheets:* Prepare pro forma balance sheets semiannually in the first year and at the end of each of the first three years of operation.

D. *Pro forma cash flow analysis:*

— Project cash flows monthly for the first year of operation and quarterly for at least the next two years, detailing the amount and timing of expected cash inflows and outflows; determine the need for and timing of additional financing and indicate peak requirements for working capital; and indicate how needed additional financing is to be obtained, such as through the equity financing, through bank loans, or through short-term lines of credit from banks, on what terms, and how it is to be repaid. Remember they are based on cash, not accrual, accounting.

— Discuss assumptions, such as those made on the timing of collection of receivables, trade discounts given, terms of payments to vendors, planned salary and wage increases, anticipated increases in any operating expenses, seasonality characteristics of the business as they affect inventory requirements, inventory turnovers per year, capital equipment purchases, and so forth. Again, these are real time (i.e., cash), not accrual.

— Discuss cash flow sensitivity to a variety of assumptions about business factors (e.g., possible changes in such crucial assumptions as an increase in the receivable collection period or a sales level lower than that forecasted).

E. *Break-even chart:*

— Calculate breakeven and prepare a chart that shows when breakeven will be reached and any stepwise changes in breakeven which may occur.

— Discuss the breakeven shown for your venture and whether it will be easy or difficult to attain breakeven, including a discussion of the size of break-even sales volume relative to projected total sales, the size of gross margins and price sensitivity, and how the break-even point might be lowered in case the venture falls short of sales projections.

F. *Cost control:* Describe how you will obtain information about report costs and how often, who will be responsible for the control of various cost elements, and how you will take action on budget overruns.

G. *Highlights:*

— Highlight the important conclusions, such as what the maximum amount of cash required is and when it will be required, the amount of debt and equity needed, how fast any debts can be repaid, etc., that can be drawn.

XII. Proposed Company Offering

The purpose of this section of the plan is to indicate the amount of any money that is being sought, the nature and amount of the securities offered to the investor, a brief description of the uses that will be made of the capital raised, and a summary of how the investor is expected to achieve its targeted rate of return. It is recommended that you read the discussion about financing in Part IV.

It is important to realize the terms for financing your company that you propose here are the *first step* in the negotiation process with those interested in investing, and it is very possible that your financing will involve different kinds of securities than originally proposed.

A. *Desired financing.* Based on your real-time cash flow projections and your estimate of how much money is required over the next three years to carry out the development and/or expansion of your business as described, indicate how much of this capital requirement will be obtained by this offering and how much will be obtained via term loans and lines of credit.

B. *Offering:*

— Describe the type (e.g., common stock, convertible debentures, debt with warrants, debt plus stock), unit price, and total amount of securities to be sold in this offering. If securities are not just common stock, indicate by type, interest, maturity, and conversion conditions.

— Show the percentage of the company that the investors of this offering will hold after it is completed or after exercise of any stock conversion or purchase rights in the case of convertible debentures or warrants.

— Securities sold through a private placement and that therefore are exempt from SEC registration should include the following statement in this part of the plan:

The shares being sold pursuant to this offering are restricted securities and may not be resold readily. The prospective investor should recognize that such securities might be restricted as to resale for an indefinite period of time. Each purchaser will be required to execute a Non-Distribution Agreement satisfactory in form to corporate counsel.

C. *Capitalization:*

— Present in tabular form the current and proposed (postoffering) number of outstanding shares of common stock. Indicate any shares offered by key management people and show the number of shares that they will hold after completion of the proposed financing.

— Indicate how many shares of your company's common stock will remain authorized but unissued after the offering and how many of these will be reserved for stock options for future key employees.

D. *Use of funds.* Investors like to know how their money is going to be spent. Provide a brief description of how the capital raised will be used. Summarize as specifically as possible what amount will be used for such things as product design and development, capital equipment, marketing, and general working capital needs.

E. *Investors' return.* Indicate how your valuation and proposed ownership shares will result in the desired rate of return for the investors you have targeted and what the likely harvest or exit mechanism (IPO, outright sale, merger, MBO, etc.) will be.

XIII. Appendixes

Include pertinent information here that is too extensive for the body of the business plan but which is necessary (product specs or photos; lists of references; suppliers of critical components; special location factors, facilities, or technical analyses; reports from consultants or technical experts; and copies of any critical regulatory approval, licenses, etc).

STEP 5

Integrate Your Discrete Sections into a Coherent and Logical Business Plan That Can Be Used for the Purpose For Which It Is Created.

STEP 6

Get Feedback; if Your Plan Is to Be Submitted to Outside Investors, Have Your Plan Reviewed By Your Attorney. Once written, it is recommended that you get the plan reviewed. No matter how good you and your team are, you will most likely overlook issues and treat aspects of your venture in a manner that is less than clear. A good reviewer can give you the benefit of an outside objective evaluation. Your attorney can make sure that there are no misleading statements in your plan and that it contains all the caveats and the like.

Chapter Summary

1. The business plan is more of a process and work in progress than an end in itself.
2. Given today's pace of change in all areas affecting an enterprise, the plan is obsolete the moment it emerges from the printer.
3. The business plan is a blueprint and flight plan for a journey that converts ideas into opportunities, articulates and manages risk and reward, and articulates the likely *fit* and timing for a venture.
4. Ironically, the numbers in a business plan don't matter, but the economics of the business model and value proposition matter enormously.
5. The plan is not the business; in fact, some of the most successful ventures ever were launched without a formal business plan or with one that would be considered weak or flawed.
6. Preparing and presenting the plan to prospective investors is one of the best ways for the team to have a trial marriage, to learn about the venture strategy, and to determine who can add the greatest value.
7. The dehydrated business plan can be a valuable shortcut in the process of creating, shaping, and molding an idea into a business.

Study Questions

1. What is a business plan, for whom is it prepared, and why?
2. What should a complete business plan include?