Chapter 11

Crafting a Winning Business Plan

The more concrete and complete the plan, the more likely it is to earn the respect of outsiders and their support in necessary financial matters.

—Jesse Werner

Good judgment comes from experience, and often experience comes from bad judgment.

—Rita Mae Brown

LEARNING OBJECTIVES

Upon completion of this chapter, you will be able to:

1. **EXPLAIN** why every entrepreneur should create a business plan and list the benefits of such a plan.
2. **DESCRIBE** the elements of a solid business plan.
3. **UNDERSTAND** the keys to making an effective business plan presentation.
4. **EXPLAIN** the "five Cs of credit" and why they are important to potential lenders and investors reading business plans.

Any entrepreneur who is in business or is about to launch a business needs a well-conceived and factually based business plan to increase the likelihood of success. For decades, research has proven that companies that engage in business planning outperform those that do not. Unfortunately, studies also show that small companies are especially lackadaisical in their approach to developing business plans. A recent survey by the market research company Willard & Shullman Group Ltd. found that only 14 percent of the small companies surveyed had created an annual written business plan. The study also reported that 60 percent of small companies had no written plans of any type![1]

WHY DEVELOP A BUSINESS PLAN?

Learning Objective

1. Explain why every entrepreneur should create a business plan and list the benefits of such a plan.

A **business plan** is a written summary of an entrepreneur's proposed business venture, its operational and financial details, its marketing opportunities and strategy, and its managers' skills and abilities. There is no substitute for a well-prepared business plan, and there are no shortcuts to creating one. The plan serves as an entrepreneur's road map on the journey toward building a successful business. It describes the direction the company is taking, what its goals are, where it wants to be, and how it's going to get there. The plan is written proof that the entrepreneur has performed the necessary research and has studied the business opportunity adequately. In short, the business plan is the entrepreneur's best insurance against launching a business destined to fail or mismanaging a potentially successful company.

business plan—*a written summary of an entrepreneur's proposed business venture, its operational and financial details, its marketing opportunities and strategy, and its managers' skills and abilities.*

A business plan serves three essential functions. First and most important, it guides the company's operations by charting its future course and devising a strategy for success. The plan provides a battery of tools—a mission statement, goals, objectives, market analysis, budgets, financial forecasts, target markets, strategies—to help entrepreneurs lead a company successfully. It gives managers and employees a sense of direction, but only if everyone is involved in creating, updating, or altering it. As more team members become committed to making the plan work, the plan takes on special meaning. It gives everyone targets to shoot for, and it provides a yardstick for measuring actual performance against those targets, especially in the crucial and chaotic start-up phase. Creating a plan also forces entrepreneurs to subject their ideas to the test of reality. Can this business idea actually produce a profit?

The second function of the business plan is to attract lenders and investors. Too often small business owners approach potential lenders and investors without having prepared to sell themselves and their business concept. Simply scribbling a few rough figures on a note pad to support a loan application is not enough. Applying for loans or attempting to interest investors without a solid business plan rarely attracts needed capital. Rather, the best way to secure the necessary capital is to prepare a sound business plan. Entrepreneurs must pay attention to detail because it is germane to their sales presentation to potential lenders and investors. In most cases, the quality of the firm's business plan weighs heavily in the decision to lend or invest funds. It is also potential lenders' and investors' first impression of the company and its managers. Therefore, the finished product should be highly polished and professional in both form and content.

A business plan must prove to potential lenders and investors that a venture will be able to repay loans and produce an attractive rate of return. Entrepreneur and author Neal Stephenson, who started several high-tech companies before focusing on a writing career, explains his experience writing a business plan:

> As I was trying to write my plan, something came into focus for me that should have been obvious from the very beginning. I was proposing to borrow a lot of money from strangers and gamble it on doing something. If it didn't work, these people would lose their money, which is a very sobering prospect. It really shakes you up and makes you think very hard about what it is you are doing. . . . We're using other people's real money, and those people could get hurt.[2]

Third, building a business the plan forces potential entrepreneurs to look at their business ideas in the harsh light of reality. It also requires owners to assess their ventures' chances of success more objectively. A well-assembled plan helps prove to outsiders that a business idea can be successful. To get external financing, an entrepreneur's plan must pass three tests with potential lenders and investors: (1) the reality test, (2) the competitive test, and (3) the value test.[3] The first two tests have both external and internal components as described next.

Reality Test

The external component of the reality test revolves around proving that a market for the product or service really does exist. It focuses on industry attractiveness, market niches, potential customers, market size, degree of competition, and similar factors. Entrepreneurs who pass this part of the reality test prove in the marketing portion of their business plans that there is strong demand for their business idea.

The internal component of the reality test focuses on the product or service itself. Can the company *really* build or provide it for the cost estimates in the business plan? Is it truly different from what competitors are already selling? Does it offer customers something of value?

Competitive Test

The external part of the competitive test evaluates the company's relative position to its key competitors. How do the company's strengths and weaknesses match up with those of the competition? Do these comparisons threaten the new company's success and survival?

The internal competitive test focuses on management's ability to create a company that will gain an edge over existing rivals. To pass this part of the competitive test, a plan must prove the quality, skill, and experience of the venture's management team. What other resources does the company have that can give it a competitive edge in the market?

Value Test

To convince lenders and investors to put their money into the venture, a business plan must prove to them that it offers a high probability of repayment or an attractive rate of return. Entrepreneurs usually see their businesses as good investments because they consider the intangibles of owning a business—gaining control over their own destinies, freedom to do what they enjoy, and others; lenders and investors, however, look at a venture in colder terms: dollar-for-dollar returns. A plan must convince lenders and investors that they will earn an attractive return on their money.

The same business basics that investors have employed for decades to evaluate the financial potential of a new venture are still valid today. Gone are the valuations of new ventures that were based on market assumptions that were, at best, flawed and overly optimistic. The collapse of the dot-coms at the end of the twentieth century proved that "smoke and mirrors" do not replace financial basics.

Today earning projections based on real numbers are important. The business model must hold water, so to speak. The venture must have a long-term strategic vision and a practical focus on operations. Entrepreneurs must be able to clearly demonstrate their knowledge of:

1. Supplies and all related cost of goods
2. Unit labor cost
3. Market-determined selling price and gross profit margins
4. Break-even point[4]

Sometimes the greatest service a business plan provides an entreprenur is the realization that "it just won't work." The time to find out a potential business idea won't succeed is in the planning stages *before* an entrepreneur commits significant resources to a venture. In other cases it reveals important problems to overcome before launching a company.

The real value in preparing a business plan is not so much in the plan itself as it is in the process an entrepreneur goes through to create the plan. Although the finished product is useful, the process of building a plan requires an entrepreneur to subject his idea to an objective, critical evaluation. What the entrepreneur learns about his company, its target market, its financial requirements, and other factors can be essential to making the venture a success. This process allows the entrepreneur to replace "I think" with "I know" and to make mistakes on paper, which is much cheaper than making them in reality. Simply put, building a business plan reduces the risk and uncertainty in launching a company by teaching the entrepreneur to do it the right way!

Because a business plan is a reflection of its creator, it should demonstrate that the entrepreneur has thought seriously about the venture and what will make it succeed. Preparing a solid plan demonstrates that the entrepreneur has taken the time to commit the idea to paper. Building a plan also forces the entrepreneur to consider both the positive and the negative aspects of the business. A detailed and thoughtfully developed business plan makes a positive first impression on those who read it. In most cases, potential lenders and investors read a business plan before they ever meet with the entrepreneur behind it. Sophisticated investors will not take the time to meet with an entrepreneur whose business plan fails to reflect a serious investment of time and energy. They know that an entrepreneur who lacks this discipline to develop a good business plan likely lacks the discipline to run a business.

The business plan should reflect the fire and passion an entrepreneur has for the venture. For this reason an entrepreneur cannot allow others to prepare the business plan for him because outsiders cannot understand the business nor envision the proposed company as well as he can. The entrepreneur is the driving force behind the business idea and is the one who can best convey the vision and the enthusiasm he has for transforming that idea into a successful business. Also, because the entrepreneur will make the presentation to potential lenders and investors, he must understand every detail of the business plan. Otherwise, an entrepreneur cannot present it convincingly and in most cases the financial institution or investor will reject it. Investors want to feel confident that an entrepreneur has realistically evaluated the risk involved in the new venture and has a strategy for addressing it. And, as you can expect, they also want to see proof that a business will be profitable and produce a reasonable rturn on their investment.

Perhaps the best way to understand the need for a business plan is to recognize the validity of the "two-thirds rule," which says that only two-thirds of the entrepreneurs with a sound and viable new business venture will find financial backing. Those that do find financial backing will only get two-thirds of what they initially requested, and it will take them two-thirds longer to get the financing than they anticipated.[5] The most effective strategy for avoiding the two-thirds rule is to build a business plan!

THE ELEMENTS OF A BUSINESS PLAN

Learning Objective

Smart entrepreneurs recognize that every business plan is unique and must be tailor-made. They avoid the off-the-shelf, "cookie-cutter" approach that produces look-alike plans. The elements of a business plan may be standard, but the way an entrepreneur tells her story should be unique and reflect her personal excitement about the new venture. If this is a first attempt at writing a business plan, it may be very helpful to seek the advice of individuals with experience in this process. Accountants, business professors, attorneys, and consultants with Small Business Development Centers can be excellent sources of advice in creating and refining a plan (for a list of Small Business Development Center locations, see the Small Business Administration's SBDC Web page at www.sba.gov/SBDC). Entrepreneurs also can use business planning software available from several companies to create their plans. Some of the most popular programs include Business Plan Pro* (Palo Alto Software), BizPlan Builder (Jian Tools), PlanMaker (Power Solutions for Business), and Plan Write (Business Resources Software). These planning packages help entrepreneurs organize the material they have researched and gathered, and they provide helpful tips on plan writing and templates for creating financial statements. These planning packages produce professional-looking business plans, but entrepreneurs who use them face one drawback: The plans they produce often look the same, as if they came from the same mold. That can be a turn-off for professional investors, who see hundreds of business plans each year.

Initially, the prospect of writing a business plan may appear to be overwhelming. Many entrepreneurs would rather launch their companies and "see what happens" than invest the

*Business Plan Pro is available at a nominal cost with this textbook.

necessary time and energy defining and researching their target markets, defining their strategies, and mapping out their finances. After all, building a plan is hard work! However, it is hard work that pays many dividends—not all of them immediately apparent. Entrepreneurs who invest their time and energy building plans are better prepared to face the hostile environment in which their companies will compete than those who do not. Earlier, we said that a business plan is like a road map that guides an entrepreneur on the journey to building a successful business. If you were making a journey to a particular destination through unfamiliar, harsh, and dangerous territory, would you rather ride with someone equipped with a road map and a trip itinerary or with someone who didn't believe in road maps or in planning trips, destinations, and layovers? Although building a business plan does not *guarantee* success, it *does* raise an entrepreneur's chances of succeeding in business.

A business plan typically ranges from 25 to 50 pages in length. Shorter plans usually are too sketchy to be of any value, and those much longer than this run the risk of never getting used or read! This section explains the most common elements of a business plan. However, entrepreneurs must recognize that, like every business venture, every business plan is unique. An entrepreneur should view the following elements as a starting point for building a plan and should modify them as needed to better tell the story of his new venture.

The Executive Summary

To summarize the presentation to each potential financial institution or investor, the entrepreneur should write an executive summary. It should be concise—a maximum of two pages—and should summarize all of the relevant points of the business venture. The executive summary is a synopsis of the entire plan, capturing its essence in a capsulized form. It should explain the basic business model and briefly describe the owners and key employees, target market(s), and financial highlights (e.g., sales projections, dollar amount requested, how the funds will be used, and how and when any loans will be repaid).

The executive summary is a written version of what is known as "the elevator pitch." Imagine yourself on an elevator with a potential lender or investor. Only the two of you are on the elevator, and you have that person's undivided attention for the duration of the ride, but the building is not very tall! To convince the investor that your business is a great investment, you must boil your message down to its essence—key points that you can communicate in just a matter of one or two minutes.

The executive summary *must* capture the reader's attention. If it misses the mark, the chances of the remainder of the plan being read are minimal. A well-developed, coherent summary introducing the financial proposal establishes a favorable first impression of the entrepreneur and the business and can go a long way toward obtaining financing. Although the executive summary is the first part of the business plan, it should be the last section written.

Mission Statement

As you learned in Chapter 3, a mission statement expresses in words an entrepreneur's vision for what her company is and what it is to become. It is the broadest expression of a company's purpose and defines the direction in which it will move. It anchors a company in reality and serves as the thesis statement for the entire business plan.

Company History

The owner of an existing small business should prepare a brief history of the operation, highlighting the significant financial and operational events in the company's life. This section should describe when and why the company was formed, how it has evolved over time, and what the owner envisions for the future. It should highlight the successful accomplishment of past objectives such as developing prototypes, earning patents, achieving market-share targets, or securing long-term customer contracts. This section also should convey the firm's image in the marketplace.

FIGURE 11.1 The Relationship Among Mission, Goals, and Objectives

Business and Industry Profile

To acquaint lenders and investors with the industry in which a company competes, an entrepreneur should describe it in the business plan. This section should begin with a statement of the company's general business goals and a narrower definition of its immediate objectives. Together they should spell out what the business plans to accomplish, how, when, and who will do it. **Goals** are broad, long-range statements of what a company plans to achieve in the future that guide its overall direction and express its *raison d'être*. In other words, they address the question: "Why am I in business?" Answering such a basic question appears to be obvious, but, in fact, many entrepreneurs cannot define the basis of their businesses.

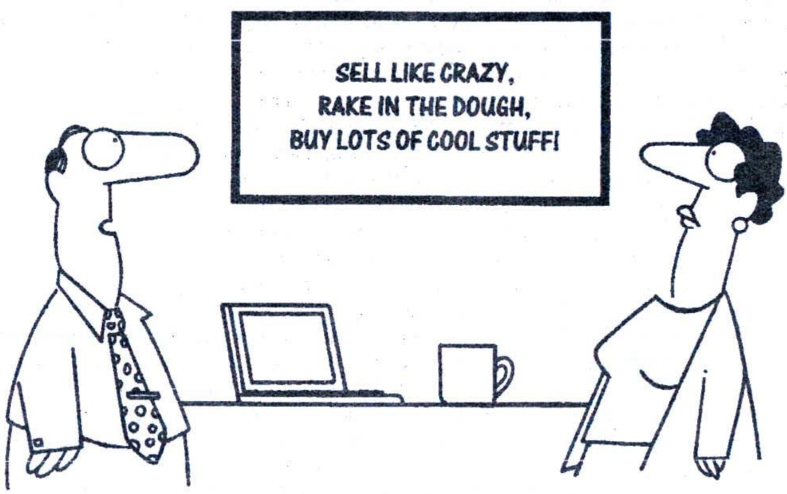
goals - *broad, long-range statements of what a company plans to achieve in the future that guide its overall direction and express its raison d'être.*

objectives—*short-term, specific performance targets that are attainable, measurable, and controllable.*

Objectives, on the other hand, are short-term, specific performance targets that are attainable, measurable, and controllable. Every objective should reflect some general business goal and include a technique for measuring progress toward its accomplishment. To be meaningful, an objective must have a time frame for achievement. Both goals and objectives should relate to the company's basic mission (see Figure 11.1).

When summarizing a small company's background, an entrepreneur should describe the present state of the art in the industry and what she will need to succeed in the market segment in which her business will compete. She should then identify the current applications of the product or service in the market and include projections for future applications.

This section should provide the reader with an overview of the industry or market segment in which the new venture will operate. Industry data such as market size, growth trends, and the relative economic and competitive strength of the major firms in the industry all set the stage for a better understanding of the viability of the new product or service. Strategic issues such as ease of market entry and exit, the ability to achieve economies of scale or scope, and the existence of cyclical or seasonal economic trends further help readers evaluate the new venture. This part of the plan also should describe significant industry trends and an overall outlook for its future. Information about the evolution of the industry helps the reader comprehend its competitive dynamics. The *U.S. Industrial Outlook Handbook* is an excellent



"Our old mission statement was more eloquent, and dignified, but not nearly as effective."

reference that profiles a variety of industries and offers projections for future trends in them. Another useful resource of industry and economic information is the *Summary of Commentary on Current Economic Conditions*, more commonly known as the *Beige Book*. Published eight times a year by the Federal Reserve, the *Beige Book* provides detailed statistics and trends in key business sectors and in the overall economy. It offers valuable information on topics ranging from tourism and housing starts to consumer spending and wage rates. Entrepreneurs can find this wealth of information at their fingertips on the Web at the Federal Reserve's Web site.

This section of the plan also should describe the existing and anticipated profitability of the industry. Any significant entry or exit of firms or consolidations and mergers should be discussed in terms of their impact on the competitive behavior of the market. The entrepreneur also should mention any events that have significantly affected the industry in the past 10 years.

Business Strategy

An even more important part of the business plan is the owner's view of the strategy needed to meet—and beat—the competition. In the previous section, the entrepreneur defined *where* he wants to take his business by establishing goals and objectives. This section addresses the question of *how* to get there—business strategy. Here an entrepreneur must explain how he plans to gain a competitive edge in the market and what sets the business apart from the competition. He should comment on how he plans to achieve business goals and objectives in the face of competition and government regulation and should identify the image that the business will try to project. An important theme in this section is what makes the company unique in the eyes of its customers. One of the quickest routes to business failure is trying to sell "me-too" products or services that offer customers nothing new, better, bigger, faster, or different. The foundation for this part of the business plan comes from the material in Chapter 3, "Strategic Management and the Entrepreneur."

This segment of the business plan should outline the methods the company can use to meet the key success factors cited earlier. If, for example, a strong, well-trained sales force is considered critical to success, the owner must devise a plan of action for assembling one.

Description of Firm's Product/Service

An entrepreneur should describe the company's overall product line, giving an overview of how customers use its goods or services. Drawings, diagrams, and illustrations may be required if the product is highly technical. It is best to write product and service descriptions so that laypeople can understand them. A statement of a product's position in the product life cycle might also be helpful. An entrepreneur should include a summary of any patents, trademarks, or copyrights protecting the product or service from infringement by competitors. Finally, it is helpful provide an honest of comparison of the company's products or services with those of competitors, citing specific advantages or improvements that make the company's goods or services unique and indicating plans for creating the next generation of goods and services that will evolve from the present product line.

The emphasis of this section should be on defining the *benefits* customers get by purchasing the company's products or services, rather than on just a "nuts and bolts" description of the *features* of those products or services. A **feature** is a descriptive fact about a product or service ("an ergonomically designed, more comfortable handle"). A **benefit** is what a customer gains from the product or service feature ("fewer problems with carpal tunnel syndrome and increased productivity"). Advertising legend Leo Burnett once said, "Don't tell the people how good you make the goods; tell them how good your goods make them."[6] This part of the plan must describe how a business will transform tangible product or service *features* into important, but often intangible, customer *benefits*—for example, lower energy bills, faster access to the Internet, less time writing checks to pay monthly bills, greater flexibility in building floating structures, shorter time required to learn a foreign language, or others. Remember: Customers buy benefits, *not* product or service features.

feature—*a descriptive fact about a product or service.*

benefit—*what a customer gains from the product or service.*

Manufacturers should describe their production process, strategic raw materials required, sources of supply they will use, and their costs. They should also summarize the production method and illustrate the plant layout. If the product is based on a patented or proprietary process, a description (including diagrams, if necessary) of its unique market advantages is helpful. It is also helpful to explain the company's environmental impact and how the entrepreneur plans to mitigate any negative environmental consequences the process may produce.

A Company Example

For example, as the value of the automobiles Americans drive increases, so does their desire to have their cars look "showroom" clean. There are 75,000 car washes in the United States varying in service and quality. Matthew Lieb and Chris Jones created SWASH as a state-of-the-art, no-muss, no-fuss, stand-alone entity where customers can select the services the equipment will provide and remain in their vehicles. All services are delivered by software-controlled equipment that never lays a brush on the car and the process is environmentally friendly from start to finish.

Stressing these types of facts to investors can help differentiate a company's product or process from competitors.

Marketing Strategy

One crucial concern of entrepreneurs and the potential lenders and investors who finance their companies is whether or not there is a real market for the proposed good or service. Every entrepreneur must, therefore, describe the company's target market and its characteristics. Defining the target market and its potential is one of the most important—and most challenging—parts of building a business plan. Creating a successful business depends on an entrepreneur's ability to attract real customers who are willing and able to spend real money to buy its products or services. Perhaps the worst marketing error an entrepreneur can commit is failing to define his target market and trying to make his business "everything to everybody." Small companies usually are much more successful by focusing on a specific market niche where they can excel at meeting customers' special needs or wants.

One new and evolving target market for small businesses is teenagers. By 2010, the number of teens will grow to 35 million, which will make them a larger target market than the much-touted baby boomers. According to the U.S. Department of Labor, the average teenager gets a staggering $50 a week in disposable income from parents, and market research shows that teens are willing to spend what they have. This group is often characterized as being the product of dual-income parents who provide their offspring with more cash than attention. Adolescence has always been a period of exploration and rebellion that results in unique attire, haircuts, and other visible signs of differences from those of their parents' generation. Today, fueled with cash and credit cards, this target market has attracted attention as their appetite for the external trappings that help them achieve peer approval results in a dizzying cycle of new "hot trend" purchases. Psychologists, manufacturers, and retailers alike analyze this market segment in hopes of gaining an edge in the accurate prediction of what the market will want.

Successful entrepreneurs know that a solid understanding of their target markets is the first step in building an effective marketing strategy. Indeed, every other aspect of marketing depends on having a clear picture of their customers and their unique needs and wants.

Questions this part of the business plan should address include: Who are the most promising customers or prospects? What are their characteristics? Where do they live? What do they buy? Why do they buy? When do they buy? What expectations do they have about the product or service? Will the business focus on a niche? How does the company seek to position itself in its market(s)?

Proving that a profitable market exists involves two steps: showing customer interest and documenting market claims.

Although many teens get either no allowance or an allowance in the $10 to $20 range, the amount of money that many parents actually give over the course of the week is substantially higher. Spending by this demographic group is quickly closing in on $200 billion a year.

Courtesy of Getty Images, Inc.-Taxi

YOU Be the consultant . . .

Are All Dot-Com Ventures Dead?

The market shakeout among the dot-coms in recent years has produced a negative perception about the financial viability of all new dot-com ventures. Is this negativity warranted, or should any new business venture be judged on its business model and forecasted financial outcomes? Today's sophisticated investors recognize that e-commerece still is in its infancy and that entrepreneurs are still trying to work out business models that will produce success in such a fast-paced, dynamic environment. A plan sporting elaborate descriptions of target customers and spreadsheets with detailed financial projections five years into the future simply is not that credible. Investors know that most e-commerce companies will fail, a situation that is not likely to change in the near future.

The financial section of an e-business plan also is much shorter than in a traditional business plan. Rather than producing reams of spreadsheets showing the outcomes of multiple scenarios many years into the future, successful Internet entrepreneurs are sticking with perhaps one or two scenarios projected just two years out. Investors recognize that few e-businesses generate sufficient revenue to make a profit, especially in the early years when development costs are so high. As e-commerce matures and becomes more stable, investors will expect more traditional types of financial forecasts.

Investors also demand less detail in the section of the plan that describes a company's target market. Normally, an entrepreneur includes in a traditional plan a thorough analysis of the market and the characteristics of the customers that comprise it. A plan for an e-business, however, recognizes that markets and the techniques for reaching customers effectively change rapidly in e-commerce. Investors want entrepreneurs behind Internet companies to summarize the market opportunity and its potential for growth.

Two areas in an e-business plan require more attention than in a traditional plan: the explanation of the business concept and the description of the management team. Before investors put any money into an e-business, they must have a crystal-clear understanding of it and how it is superior to any current business model. "You had better have a very simple way to powerfully differentiate your company," advises venture capitalist Guy Kawasaki. E-commerce plans include definitions of industry-specific terms, diagrams of technology, hyperlinks to Web sites, and charts showing how a company works.

Just as in a traditional business, investors evaluating an e-commerce plan are looking for a skilled, experienced management team that can prove it has the wherewithal to launch a company and manage it through the tremulous start-up phase. "Launching an e-business is not for the weak-minded nor the weak-hearted," says one expert. Investors are especially interested in how the company will draw customers to its Web site and how it will handle and fulfill orders from them once they arrive. An e-business plan, therefore, should contain a Web site map that shows how all of the pages on the site will look and be linked to one another. Presentations can also include a DVD version of the Web site's characteristics or a live hook-up that shows the investor exactly what the customer will experience when using the site. This can be a bit risky—the worst that can happen sometimes will happen when "going live" in front of a group of potential investors! A plan should also describe how the company's back office, the systems that take over once a customer places an order on the site, will work and the volume of traffic it can handle.

Just as with a traditional business plan, the executive summary in an e-business plan is extremely important because it is the first section investors read. If it fails to capture investors' attention and interest, the probability that they will read the rest of the plan is miniscule.

1. In what ways are a plan for a traditional business and one for an e-business similar? Different?

2. Suppose that a good friend comes to you and announces that he is going to launch an Internet business but needs financing to do it. You ask about his business plan. "I don't have the time to write a business plan," he says. What do you tell him?

3. Assume that you convince your friend that he should write a business plan. He asks your advice on how to write the plan. What advice would you offer?

Sources: Adapted from Mark Henricks, "Short and Sweet," *Business Start-Ups*, May 2000, p. 20; Joel Kirtzman, "The New Age of Business Plans," *Fortune*, September 27, 2000, p. 262 (N); Robert Calem, Sherly Nance-Nash, Michael Scully, and Carlye Adler, "Napkin Plans . . . The Main Street Mayor . . . Silicon Goes Celluloid," *Fortune*, May 24, 1999, p. 296 (I); Guy Kawaski, "Needbucks.com" *Forbes*, January 10, 2000, p. 1998.

SHOWING CUSTOMER INTEREST. An entrepreneur must be able to prove that her target customers need or want her good or service and are willing to pay for it. This phase is relatively straightforward for a company with an existing product or service but can be quite difficult for one with only an idea or a prototype. In this case the entrepreneur might offer the prototype to several potential customers in order to get written testimonials and evaluations to show to investors. Or the owner could sell the product to several customers at a discount. This would prove that there are potential customers for the product and would allow demonstrations of the product in operation. Getting a product into customers' hands is also an excellent way to get valuable feedback that can lead to significant design improvements and increased sales down the road.

DOCUMENTING MARKET CLAIMS. Too many business plans rely on vague generalizations such as, "This market is so huge that if we get just 1 percent of it, we will break even in eight months." Such statements are not backed by facts and usually reflect an entrepreneur's unbridled optimism. In most cases, they are also unrealistic! Market share determination is not obtained by a "shoot from the hip" generalization; to the contrary, sophisticated investors expect to be shown the detailed research that supports the claims made about the potential of the market.

Entrepreneurs must support claims of market size and growth rates with *facts*, and that requires market research. Results of market surveys, customer questionnaires, and demographic studies lend credibility to an entrepreneur's frequently optimistic sales projections. (Refer to the market research techniques and resources in Chapter 6.) Many entrepreneurs build financial models for their potential businesses by applying facts and formulas based on data available from the relevent trade or professional associations, local market data, and, with the assistance of the Small Business Development Center, data that are available in independent federal databases or from sources such as Dun & Bradstreet or Robert Morris Associates.

Quantitative market data are important because they form the basis for all of the company's financial projections in the business plan. One technique involves **business prototyping**, in which entrepreneurs test their business models on a small scale before committing serious resources to a business that might not work. Business prototyping recognizes that every business idea is a hypothesis that needs to be tested before an entrepreneur takes it to full scale. If the test supports the hypothesis and its accompanying assumptions, it is time to launch a company. If the prototype flops, the entrepreneur scraps the business idea with only minimal losses and turns to the next idea.

business prototyping—*a process in which entrepreneurs test their business models on a small scale before committing serious resources to a business that may or may not work.*

The World Wide Web makes business prototyping practical, fast and easy.

A Company Example

For instance, after successfully selling antiques on the online auction site EBay, Nona Cunane decided to test the market for products she was more interested in: upscale designer clothing for women. When her business prototype proved to be successful on EBay, Cunane launched an online company of her own, ***Stylebug.com****. The Bear, Delaware-based business sells more than $800,000 of women's clothing a year, about half of it still on EBay.*[7]

An effective market analysis also should identify the following:

Advertising: Once an entrepreneur defines her company's target market, she can design a promotion and advertising campaign to reach those customers most effectively and efficiently. Which media are most effective in reaching the target market? How will they be used? How much will the promotional campaign cost? How can the company benefit from publicity?

Market size and trends: How large is the potential market? Is it growing or shrinking? Why? Are the customer's needs changing? Are sales seasonal? Is demand tied to another product or service?

Location: For many businesses, choosing the right location is a key success factor. For retailers, wholesalers, and service companies, the best location usually is one that is most convenient to their target customers. By combining census data and other market research with digital mapping software, entrepreneurs can locate sites with the greatest concentrations of their customers and the least interference from competitors. Which specific sites put the company in the path of its target customers? Do zoning regulations restrict the use of the site? For manufacturers, the location issue often centers on finding a site near key raw materials or near major customers. Using demographic reports and market research to screen potential sites takes the guesswork out of choosing the "right" location for a business.

Pricing: What does the product or service cost to produce or deliver? What is the company's overall pricing strategy? What image is the company trying to create in the market? Will the planned price support the company's strategy and desired image? (See Figure 11.2.) Can it produce a profit? How does the planned price compare to those of similar products or services? Are customers willing to pay it? What price tiers exist in the market? How sensitive are customers to price changes? Will the business sell to customers on credit? Will it accept credit cards?

Distribution: How will the product or service be distributed? What is the average sale? How many sales calls does it take to close a sale? What are the incentives for salespeople? What can the company do to make it as easy as possible for customers to buy?

This portion of the plan also should describe the channels of distribution that the business will use (mail, in-house sales force, sales agent, retailers). The entrepreneur should summarize the firm's overall pricing and promotion strategies, including the advertising budget, media used, and publicity efforts. The company's warranties and guarantees for its products and services should be addressed as well.

Competitor Analysis

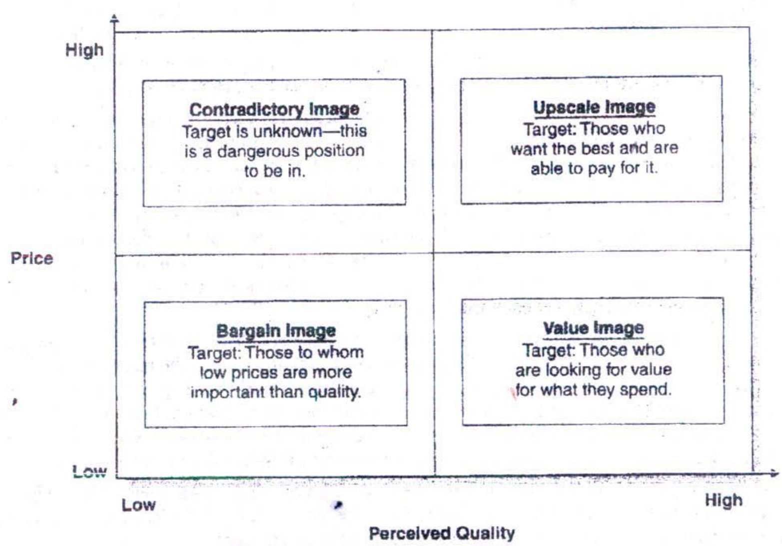
An entrepreneur should discuss the new venture's competition. Failing to assess competitors realistically makes entrepreneurs appear to be poorly prepared, naive, or dishonest, especially to potential lenders and investors. This section of the plan should include an analysis of each significant competitor. Entrepreneurs who believe they have no competitors are only fooling themselves. Gathering information on competitors' market shares, products, and strategies is usually not difficult. Trade associations, customers, industry journals, marketing representatives, and sales literature are valuable sources of data. This section of the plan should focus on demonstrating that the entrepreneur's company has an advantage over its competitors. Who are the company's key competitors? What are their strengths and weaknesses? What are their strategies? What images do they have in the marketplace? How successful are they? What distinguishes the entrepreneur's product or service from others already on the market, and how will these differences produce a competitive edge?

Description of the Management Team

The most important factor in the success of a business venture is the quality of its management, and financial officers and investors weigh heavily the ability and experience of the firm's managers in their financing decisions. Thus, a plan should describe the qualifications of business officers, key directors, and any person with at least 20 percent ownership in the company. *Remember: Lenders and investors prefer experienced managers.* A management team with industry experience and a proven record of success goes a long way in adding credibility to the new venture.

Résumés in a plan should summarize an individual's education, work history (emphasizing managerial responsibilities and duties), and relevant business experience. When compiling a personal profile, an entrepreneur should review the primary reasons for small business failure (refer to Chapter 1) and show how her team will use its skills and experience to avoid them. Entrepreneurs should not cover up previous business failure, however. Failing in business no

FIGURE 11.2 The Link Between Pricing Perceived Quality and Company Image



longer has a terrible stigma attached to it. In fact, many investors are suspicious of entrepreneurs who have never experienced a business failure.

When considering investing in a business, lenders and investors look for the experience, talent, and integrity of the people who will breathe life into the plan. This portion of the plan should show that the company has the right people organized in the right fashion for success. One experienced private investor advises entrepreneurs to remember the following:

- Ideas and products don't succeed; people do. Show the strength of your management team. A top-notch management team with a variety of proven skills is crucial.
- Show the strength of key employees and how you will retain them. Most small companies cannot pay salaries that match those at large businesses, but stock options and other incentives can improve employee retention.
- A board of directors or advisors consisting of industry experts lends credibility and can enhance the value of the management team.[8]

Plan of Operation

To complete the description of the business, the owner should construct an organizational chart identifying the business's key positions and the personnel occupying them. Assembling a management team with the right stuff is difficult, but keeping it together until the company is established may be harder. Thus, the entrepreneur should describe briefly the steps taken to encourage important officers to remain with the company. Employment contracts, shares of ownership, and perks are commonly used to keep and motivate such employees.

Finally, a description of the form of ownership (partnership, joint venture, S corporation, or LLC) and of any leases, contracts, and other relevant agreements pertaining to the business is helpful.

Forecasted or Pro Forma Financial Statements

One of the most important sections of the business plan is an outline of the proposed company's financial statements—the "dollars and cents" of the proposed venture. For an existing business, lenders and investors use past financial statements to judge the health of the company and its ability to repay loans or generate adequate returns; therefore, an owner should supply copies of the firm's financial statements from the past three years. Ideally, these statements should be audited by a certified public accountant because most financial institutions prefer that extra reliability, although a financial review of the statements by an accountant sometimes may be acceptable.

Whether assembling a plan for an existing business or for a start-up, an entrepreneur should carefully prepare monthly projected (or pro forma) financial statements for the operation for the next year (and for two or three more years by quarter) using past operating data, published statistics, and judgment to derive three sets of forecasts of the income statement, balance sheet, cash budget (always!), and schedule of planned capital expenditures. (Refer to Chapter 10, "Creating a Successful Financial Plan," for a discussion on creating projected financial statements.) The forecasts should cover pessimistic, most likely, and optimistic conditions to reflect the uncertainty of the future. When in doubt, be up front and include some contingencies for any costs that you are unsure about.

It is essential that all three sets of forecasts be realistic. Entrepreneurs must avoid the tendency to "fudge the numbers" just to make their businesses look good. Lenders and investors compare these projections against published industry standards and can detect unrealistic forecasts. In fact, some venture capitalists automatically discount an entrepreneur's financial projections by as much as 50 percent. Upon completing the forecasts, an entrepreneur should perform a break-even analysis and a ratio analysis on the projected figures.

It is also important to include a statement of the *assumptions* on which these financial projections are based. Potential lenders and investors want to know how an entrepreneur derived forecasts for sales, cost of goods sold, operating expenses, accounts receivable, collections, accounts payable, inventory, taxes, and other items. Spelling out such assumptions gives a plan more credibility and reduces the tendency to include overly optimistic estimates of sales growth and profit margins. In addition to providing valuable information to potential lenders and investors, projected financial statements help an entrepreneur run her business more effectively and more efficiently. They establish important targets for financial performance and make it easier for an entrepreneur to maintain control over routine expenses and capital expenditures.

The Loan or Investment Proposal

The loan or investment proposal section of the business plan should state the purpose of the financing, the amount requested, and the plans for repayment or, in the case of investors, an attractive exit strategy. When describing the purpose of the loan or investment, an entrepreneur must specify the planned use of the funds. General requests for funds using terms such as "for modernization," "working capital," or "expansion" are unlikely to win approval. Instead, entrepreneurs should use more detailed descriptions such as "to modernize production facilities by purchasing five new, more efficient looms that will boost productivity by 12 percent" or "to rebuild merchandise inventory for fall sales peak, beginning in early summer." Entrepreneurs should state the precise amount requested and include relevant backup data, such as vendor estimates of costs or past production levels. An entrepreneur should not hesitate to request the amount of money needed but should not inflate the amount anticipating the financial officer to "talk her down." Remember: Lenders and investors are normally very familiar with industry cost structures.

Another important element of the loan or investment proposal is the repayment schedule or exit strategy. A lender's main consideration in granting a loan is the assurance that the applicant will repay, whereas an investor's major concern is earning a satisfactory rate of return. Financial projections must reflect a firm's ability to repay loans and produce adequate yields. Without this proof, a request for additional funds stands little chance of being accepted. It is necessary for the entrepreneur to produce tangible evidence showing the ability to repay loans or to generate attractive returns. "Plan an exit for the investor," advises the owner of a financial consulting company. "Generally, the equity investor's objective with early stage funding is to earn a 30 percent to 50 percent annual return over the life of the investment. To enhance the investor's interest in your enterprise, show how they can 'cash out' perhaps through a public offering or acquisition."[9]

Finally, the owner should have a timetable for implementing the proposed plan. He should present a schedule showing the estimated start-up date for the project and noting any significant milestones along the way. Entrepreneurs tend to be optimistic, so document how and why the timetable of events is realistic.

It is beneficial to include an evaluation of the risks of a new venture. Evaluating risk in a business plan requires an entrepreneur to walk a fine line, however. Dwelling too much on everything that can go wrong will discourage potential lenders and investors from financing the venture. Ignoring the project's risks makes those who evaluate the plan tend to believe an entrepreneur to be either naive, dishonest, or unprepared. The best strategy is to identify the most significant risks the venture faces and then to describe the plans the entrepreneur has developed to avoid them altogether or to overcome the negative outcome if the event does occur.

There is a difference between a *working* business plan—the one the entrepreneur is using to guide her business—and the *presentation* business plan—the one she is using to attract capital. Although coffee rings and penciled-in changes in a working plan don't matter (in fact, they're a good sign that the entrepreneur is actually using the plan), they have no place on a plan going to someone outside the company. A plan is usually the tool that an entrepreneur uses to make a first impression on potential lenders and investors. To make sure that impression is a favorable one, an entrepreneur should follow these tips:

- First impressions are crucial. Make sure the plan has an attractive (not necessarily expensive) cover.
- Make sure the plan is free of spelling and grammatical errors and "typos." It is a professional document and should look like one.
- Make it visually appealing. Use color charts, figures, and diagrams to illustrate key points. Don't get carried away, however, and end up with a "comic book" plan.
- Include a table of contents to allow readers to navigate the plan easily. Reviewers should be able to look through a plan and quickly locate the sections they want to see.
- Make it interesting. Boring plans seldom get read.

- A plan must prove that the business will make money. In one survey of lenders, investors, and financial advisors, 81 percent said that, first and foremost, a plan should prove that a venture will earn a profit.[10] Start-ups do not necessarily have to be profitable immediately, but sooner or later (preferably sooner), they must make money.
- Use computer spreadsheets to generate financial forecasts. They allow entrepreneurs to perform valuable "what if" (sensitivity) analysis in just seconds.
- *Always* include cash flow projections. Entrepreneurs sometimes focus excessively on their proposed venture's profit forecasts and ignore cash flow projections. Although profitability is important, lenders and investors are much more interested in cash flow because they know that's where the money to pay them back or to cash them out comes from.
- The ideal plan is "crisp," long enough to say what it should but not so long that it is a chore to read.
- Tell the truth. Absolute honesty is always critical when preparing a business plan.

When a visitor to New York City once asked a native New Yorker the question, "How do I get to Carnegie Hall?" the answer was, "practice, practice, practice."

A Company Example

The same is true for the fortunate candidates selected to participate in the Springboard Venture Capital Forums, a nonprofit organization that aggressively recruits the best and brightest female entrepreneurs. The success rate of its graduates in raising venture capital is astounding, with nearly 40 percent raising in excess of $700 million from venture capitalists and "angels." A recent venture capital forum presented 23 entrepreneurs selected by Springboard from a pool of 150 applicants. Ultimately, the 23 entrepreneurs have 10 minutes to present their business plans to an audience of 200 to 300 potential investors. ***Springboard Enterprise*** *requires that each of the finalists rehearse, present, be critiqued, rework her presentation, and begin the cycle again. In the most recent round, the 23 finalists had the consultants of the prestigious global consulting firm McKinsey and Company provide each of them with a one-hour critique of their presentation. The consultants focused on the presentation's content, quality of the visuals, use of time, and the presenter's style of delivery. A week later came the dress rehearsals with a round of suggestions from a panel of venture capitalists, executive coaches, consultants, and lawyers. Twenty-four hours before the forum, the 23 entrepreneurs participate in a technical dress rehearsal. This is the last opportunity to put the final touches on the 10-minute presentation.*

For most of this group of entrepreneurs, the final presentation reflected all the days, weeks, and months of preparation and rehearsal. Most of the presentations were extremely professional and well received. Springboard Enterprise again delivered the "goods," and the venture capitalists and private investors had an opportunity on one day to preview 23 high-potential business plans.[11]

MAKING THE BUSINESS PLAN PRESENTATION

3. Understand the keys to making an effective business plan presentation.

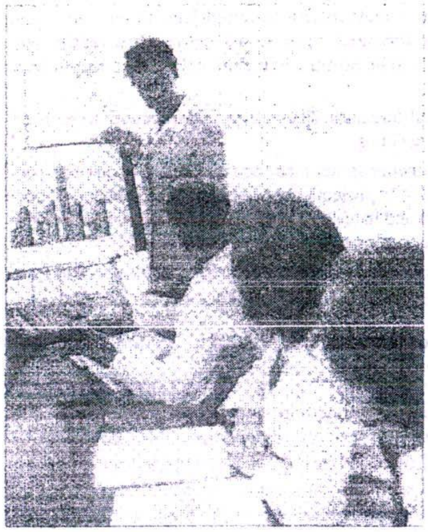
Lenders and investors are favorably impressed by entrepreneurs who are informed and prepared when requesting a loan or investment. When attempting to secure funds from professional venture capitalists or private investors, the written business plan almost always precedes the opportunity to meet "face-to-face." Typically, an entrepreneur's time for presenting her business opportunity will be quite limited. (When presenting a plan to a venture capital forum, the allotted time is usually no more than 15 to 20 minutes, and at some forums, the time limit is a mere five or six minutes.) When the opportunity arises, an entrepreneur must be well prepared. It is important to rehearse, rehearse, and then rehearse some more. It is a mistake to begin by leading the audience into a long-winded explanation about the technology on which the product or service is based. Within minutes most of the audience will be lost, and so is any chance the entrepreneur has of obtaining the necessary financing for her new venture.

Some helpful tips for making a business plan presentation to potential lenders and investors include:

- Demonstrate enthusiasm about the venture but don't be overly emotional.
- Know your audience thoroughly and work to establish a rapport with them.
- "Hook" investors quickly with an up-front explanation of the new venture, its opportunities, and the anticipated benefits to them.

Entrepreneurs typically have a limited amount of time to present their ideas to potential lenders and investors. Planning, preparation, and enthusiasm are key elements to a successful presentation.

Courtesy of Getty Images - EyeWire, Inc.



- Hit the highlights; specific questions will bring out the details later. Don't get caught up in too much detail in early meetings with lenders and investors.
- Keep your presentation simple by limiting it to the two or three (no more) major points you must get across to your audience.
- Avoid the use of technological terms that will likely be above most of the audience. Do at least one rehearsal before someone who has no special technical training. Tell him to stop you anytime he does not understand what you are talking about. When this occurs (and it likely will), rewrite that portion of your presentation.
- Use visual aids. Although they make it easier for people to follow your presentation, do not make the visual aids the "star" of the presentation. They should merely support and enhance your message.
- Close by reinforcing the nature of the opportunity. Be sure you have sold the benefits the investors will realize when the business is a success.
- Be prepared for questions. In many cases, there is seldom time for a long "Q&A" session, but interested investors may want to get you aside to discuss the details of the plan.
- Follow up with every investor to whom you make a presentation. Don't sit back and wait; be proactive. They have what you need—investment capital. Demonstrate that you have confidence in your plan and have the initiative necessary to run a business successfully.

WHAT LENDERS AND INVESTORS LOOK FOR IN A BUSINESS PLAN

4. Explain the "five Cs of credit" and why they are important to potential lenders and investors reading business plans.

Banks will rarely be a new venture's sole source of capital because a bank's return is limited by the interest rate it negotiates, but its risk could be the entire amount of the loan if the new business fails. Once a business is operational and has established a financial track record, however, banks become a regular source of financing. For this reason the small business owner needs to be aware of the criteria lenders and investors use when evaluating the creditworthiness of entrepreneurs seeking financing. Lenders and investors refer to these criteria as the **five Cs of credit:** capital, capacity, collateral, character, and conditions.

five Cs of credit—*criteria lenders and investors use to evaluate the creditworthiness of entrepreneurs seeking financing: capital, capacity, collateral, character, and conditions.*

Capital

A small business must have a stable capital base before any lender is willing to grant a loan. Otherwise the lender would be making, in effect, a capital investment in the business. Most banks refuse to make loans that are capital investments because the potential for return on the investment is limited strictly to the interest on the loan, and the potential loss would probably exceed the reward. In fact, the most common reasons that banks give for rejecting small business loan applications are undercapitalization and too much debt. Banks expect a small company to have an equity base of investment by the owner(s) that will help support the venture during times of financial strain, which are common during the start-up and growth phases of a business. Lenders and investors see capital as a risk-sharing strategy with entrepreneurs.

Capacity

A synonym for capacity is cash flow. Lenders and investors must be convinced of the firm's ability to meet its regular financial obligations and to repay loans, and that takes cash. In Chapter 9, we saw that more small businesses fail from lack of cash than from lack of profit.

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The Presentation

Dick Bardow sat quietly in his car, pondering why he had failed to convince Pat Guinn, managing partner of Next Century Venture Capital, to provide the start-up capital he needed to start the business that would launch his new high-tech medical invention. Bardow had spent the past three-and-a-half years researching and developing the concept, and now that he had a product in hand, he was ready to take it to the market. The idea for Bardow's new venture had been simmering for many years during his stints as a researcher for a major medical lab and as a technical advisor for a medical products company. Bardow had learned a great deal about the use of the end product in his technical job, which he took after earning a master's degree in biomedical engineering. It was during his tenure at the medical lab that Bardow saw the importance of staying on the cutting edge of technology in the field of medicine. He also saw the tremendous profit potential of successful medical products.

Driving home, Bardow replayed his meeting with Guinn in his mind. "How could those venture capitalists have missed the tremendous opportunity right in front of them?" he mused. During his 45-minute meeting with Guinn and her staff, Bardow had spent 30 minutes explaining how the technology had evolved over time, how he had developed the product, and why it was technologically superior to anything currently on the market. "I've got them where I want them, now," he remembered thinking. "They can't help but see the incredible power of this technology." Throughout his corporate career, Bardow had earned a reputation for his ability to explain abstract ideas and highly technical concepts to his fellow scientists. Over the years, he had made dozens of presentations at scientific professional meetings, all of which were well received.

Bardow had to admit, however, that he was really puzzled by all of the questions Guinn had asked him toward the end of their meeting. They weren't at all what he was expecting! "She never asked a single question about my product, its design, the technology behind it, or the patent I have pending," he muttered. He remembered her questioning him about a "market analysis" and how and to whom he planned to market his product. "How foolish!" he thought. "You can't forecast exact sales for a new product. Once this product is on the market and the medical industry sees what it can do, we'll have all the sales we'll need—and more." Bardow was convinced that Guinn simply didn't understand that new, innovative products create their own markets. "I've seen it dozens of times," he said. Bardow was beginning to believe that venture capital firms were too focused, on revenues, profits, and return on investment. "Don't they know that those things are outcomes?" he thought. "They come . . . in time."

1. Identify the possible problems with Dick Bardow's presentation of his business plan to Ms. Guinn.

2. Should potential lenders and investors evaluate new ventures that are based on cutting-edge technology differently from other business ventures? Explain.

3. List at least five suggestions you would make to Dick Bardow to improve his business plan and his presentation of it.

It is possible for a company to be showing a profit and still have no cash—that is, to be technically bankrupt. Lenders expect small businesses to pass the test of liquidity, especially for short-term loans. Potential lenders and investors examine closely a small company's cash flow position to decide whether it has the capacity necessary to survive until it can sustain itself.

Collateral

Collateral includes any assets an entrepreneur pledges to a lender as security for repayment of a loan. If the company defaults on the loan, the lender has the right to sell the collateral and use the proceeds to satisfy the loan. Typically, banks make very few unsecured loans (those not backed by collateral) to business start-ups. Bankers view the entrepreneurs' willingness to pledge collateral (personal or business assets) as an indication of their dedication to making the venture a success. A sound business plan can improve a banker's attitude toward the venture.

Character

Before extending a loan to or making an investment in a small business, lenders and investors must be satisfied with an entrepreneur's character. The evaluation of character frequently is based on intangible factors such as honesty, integrity, competence, polish, determination, intelligence, and ability. Although the qualities judged are abstract, this evaluation plays a critical role in the decision to put money into a business or not.

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Battle of the Plans

Unlike most summer campers, the girls attending Camp Startup in Wellesley, Massachusetts, do not take lessons in handling canoes, tying knots, or ornithology. Instead, these entrepreneurs-to-be are learning how to put together a business plan for a fictitious company they plan to launch. Like the participants in Camp Startup, students in colleges and universities across the United States are also creating business plans for companies they hope to start or, in some cases, have already launched. For some, what is at stake involves much more than just a good grade. They are competing for real start-up money and valuable feedback from judges in business plan competitions. In the typical business plan competition, students submit plans and make presentations to panels of judges that include venture capitalists, successful entrepreneurs, private investors, and potential lenders.

More than 50 colleges and universities across the United States sponsor business plan competitions, and it is not uncommon for the winners to attract impressive amounts of venture capital from judges. "I have been amazed at the quality of the plans and the companies coming out of these competitions," says Steve Kaplan of the University of Chicago. One student team at Harvard's business plan competition went on to launch the company for which they created the plan, Chemdex, an e-commerce site that buys and sells life science products. The young entrepreneurs raised $13 million from one of the nation's most well-known venture capital firms and has since made a public stock offering . . . and it was only a *runner-up* in the competition! The winning company was an Internet consulting company named Zefer that attracted $100 million in start-up capital, the largest private funding ever for an Internet start-up.

Although most of the leading schools in the field of entrepreneurship sponsor business plan competitions, perhaps the most famous contest is MIT's $50K Entrepreneurship Competition, which has stimulated the creation of more than 50 companies that have gone on to attract $175 million in venture financing and have created more than 600 jobs! When Mike Cassidy and his two partners won the $50K competition with their plan for Stylus Innovation, a computer software company, Cassidy and his team parlayed the status of their victory into $125,000 in additional venture capital. Cassidy managed the fast-growing company for several years before selling it for $13 million. Unwilling to retire at age 33, he began looking for an Internet company to manage. Cassidy returned to MIT's Web site, where he found descriptions of the businesses the student teams were proposing for the $50K competition. One business in particular, Direct Hit Technologies, an Internet search engine company, caught Cassidy's attention. He approached Gary Culliss, who came up with the idea for Direct Hit, and within days signed on as the company's CEO. Culliss's team did not win a warm-up round of the $50K competition it entered, but with Cassidy's help, the entrepreneurs began reworking the business plan. The retooling worked, and Direct Hit scored a direct hit, winning $30,000 in the competition. Culliss and Cassidy went on to raise $1.4 million in venture capital and to launch Direct Hit successfully, at which time they graciously returned the $30,000 prize money that got them started.

1. If your school does not already have a business plan competition, work with a team of your classmates in a brainstorming session to develop ideas for creating one. What would you offer as a prize? How would you finance the competition? Whom would you invite to judge it? How would you structure the competition?

2. Use the World Wide Web to research business plan competitions at other colleges and universities across the nation. Using the competitions at these schools as benchmarks and the ideas you generated in Question 1, develop a format for a business plan competition at your school.

3. Assume that you are a member of a team of entrepreneurial students entered in a prestigious business plan competition. Outline your team's strategy for winning the competition.

Sources: Adapted from Jane Hodges, "Eat S'Mores? No. Draft a Business Plan," *Fortune*, September 27, 1999, p. 294; Marc Ballon, "MIT Springboard Sends Internet Company Aloft," *Inc.*, December 1998, pp. 23–25; MIT $50K Entrepreneurship Competition, http://50k.mit.edu; Alex Frankel, "Battle of the Business Plans," *Forbes ASAP*, August 23, 1999, pp. 22–24; Michael Warshaw, "The Best Business Plan on the Planet," *Inc.*, August 1999, pp. 80–90.

Lenders and investors know that most small businesses fail because of incompetent management, and they try to avoid extending loans to high-risk entrepreneurs. A solid business plan and a polished presentation by the entrepreneur can go far in convincing the banker of the owner's capability.

Conditions

The conditions surrounding a funding request also affect an entrepreneur's chances of receiving financing. Lenders and investors consider factors relating to a business's operation such as potential growth in the market, competition, location, strengths, weaknesses, opportunities, and threats. Again, the best way to provide this relevant information is in a business plan. Another important condition influencing the banker's decision is the shape of the overall economy, including interest rate levels, inflation rate, and demand for money. Although these factors are beyond an entrepreneur's control, they still are an important component in a banker's decision.

The higher a small business scores on these five Cs, the greater its chance will be of receiving a loan. The wise entrepreneur keeps this in mind when preparing a business plan and presentation.

CONCLUSION

Although there is no guarantee of success when launching a business, the best way to ensure against failure is to create a business plan. A good plan serves as an entrepreneurial strategic compass that keeps a business on course as it travels into an uncertain future. Also, a solid plan is essential to raising the capital needed to start a business; lenders and investors demand it. It is absolutely essential for the business plan to be built on facts and realistic assumptions. Nothing destroys an entrepreneur's credibility faster than a document or presentation that lacks substance and is viewed by potential investors as a complete fabrication or an exercise in wishful thinking. Of course, building a business plan is just one step along the path to launching a business. Building a successful business requires entrepreneurs to put the plan into action. The remaining chapters in this book focus on putting your business plan to work.

BUSINESS PLAN FORMAT

Although every company's business plan will be unique, reflecting its individual circumstances, certain elements are universal. The following outline summarizes these components:

I Executive Summary (not to exceed two pages)

- A. Company name, address, and phone number
- B. Name(s), addresses, and phone number(s) of all key people
- C. Brief description of the business, its products and services, and the customer problems they solve
- D. Brief overview of the market for your products and services
- E. Brief overview of the strategies that will make your firm a success
- F. Brief description of the managerial and technical experience of key people
- G. Brief statement of the financial request and how the money will be used
- H. Charts or tables showing highlights of financial forecasts

II Vision and Mission statement

- A. Entrepreneur's vision for the company
- B. "What business are we in?"
- C. Values and principles on which the business stands
- D. What makes the business unique? What is the source of its competitive advantage?

III Company History (for existing businesses only)

- A. Company founding
- B. Financial and operational highlights
- C. Significant achievements

IV Business and Industry Profile

- A. Stage of growth (start-up, growth, maturity)
- B. Company goals and objectives
  - 1. Operational
  - 2. Financial
  - 3. Other
- C. Industry analysis
  - 1. Industry background and overview
  - 2. Significant trends

3. Growth rate
4. Key success factors in the industry
5. Outlook for the future

V Business strategy
   A. Desired image and position in market
   B. SWOT analysis
      1. Strengths
      2. Weaknesses
      3. Opportunities
      4. Threats
   C. Competitive strategy
      1. Cost-leadership
      2. Differentiation
      3. Focus

VI Company Products and Services
   A. Description
      1. Product or service features
      2. Customer benefits
      3. Warranties and guarantees
      4. Uniqueness
   B. Patent or trademark protection
   C. Description of production process (if applicable)
      1. Raw materials
      2. Costs
      3. Key suppliers
   D. Future product or service offerings

VII Marketing Strategy
   A. Target market
      1. Complete demographic profile
      2. Other significant customer characteristics
   B. Customers' motivation to buy
   C. Market size and trends
      1. How large is the market?
      2. Is it growing or shrinking? How fast?
   D. Advertising and promotion
      1. Media used—reader, viewer, listener profiles
      2. Media costs
      3. Frequency of usage
      4. Plans for generating publicity
   E. Pricing
      1. Cost structure
         a. Fixed
         b. Variable
      2. Desired image in market
      3. Comparison against competitors' prices
   F. Distribution strategy
      1. Channels of distribution used
      2. Sales techniques and incentives

VIII Location and Layout

- A. Location
  - 1. Demographic analysis of location vs. target customer profile
  - 2. Traffic count
  - 3. Lease/Rental rates
  - 4. Labor needs and supply
  - 5. Wage rates
- B. Layout
  - 1. Size requirements
  - 2. Americans with Disabilities compliance
  - 3. Ergonomic issues
  - 4. Layout plan (suitable for an appendix)

IX Competitor Analysis

- A. Existing competitors
  - 1. Who are they? Create a competitive profile matrix.
  - 2. Strengths
  - 3. Weaknesses
- B. Potential competitors: Companies that might enter the market
  - 1. Who are they?
  - 2. Impact on your business if they enter

X Description of management team

- A. Key managers and employees
  - 1. Their backgrounds
  - 2. Experience, skills, and know-how they bring to the company
- B. Resumes of key managers and employees (suitable for an appendix)

XI Plan of Operation

- A. Form of ownership chosen and reasoning
- B. Company structure (organization chart)
- C. Decision making authority
- D. Compensation and benefits packages

XII Financial Forecasts (suitable for an appendix)

- A. Financial statements
  - 1. Income statement
  - 2. Balance sheet
  - 3. Cash flow statement
- B. Break-even analysis
- C. Ratio analysis with comparison to industry standards (most applicable to existing businesses)

XIII Loan or Investment Proposal

- A. Amount requested
- B. Purpose and uses of funds
- C. Repayment or "cash out" schedule (exit strategy)
- D. Timetable for implementing plan and launching the business

XIV Appendices—Supporting documentation, including market research, financial statements, organization charts, resumes, and other items.

CHAPTER SUMMARY

1. Explain why every entrepreneur should create a business plan.

- A business plan serves two essential functions. First and most important, it guides the company's operations by charting its future course and devising a strategy for following it. The second function of the business plan is to attract lenders and investors. Applying for loans or attempting to interest investors without a solid business plan rarely attracts needed capital.

2. Explain the benefits of preparing a plan.

- Preparing a sound business plan clearly requires time and effort, but the benefits greatly exceed the costs. Building the plan forces a potential entrepreneur to look at her business idea in the harsh light of reality. It also requires the owner to assess the venture's chances of success more objectively. A well-assembled plan helps prove to outsiders that a business idea can be successful.
- The *real* value in preparing a business plan is not so much in the plan itself as it is in the process the entrepreneur goes through to create the plan. Although the finished product is useful, the process of building a plan requires an entrepreneur to subject his idea to an objective, critical evaluation. What the entrepreneur learns about his company, its target market, its financial requirements, and other factors can be essential to making the venture a success.

3. Describe the elements of a solid business plan.

- Although a business plan should be unique and tailor-made to suit the particular needs of a small company, it should cover these basic elements: an executive summary, a mission statement, a company history, a business and industry profile, a description of the company's business strategy, a profile of its products or services, a statement explaining its marketing strategy, a competitor analysis, owners' and officers' résumés, a plan of operation, financial data, and the loan or investment proposal.

4. Understand the keys to making an effective business plan presentation.

- Lenders and investors are favorably impressed by entrepreneurs who are informed and prepared when requesting a loan or investment.
- Tips include: Demonstrate enthusiasm about the venture, but don't be overly emotional; "hook" investors quickly with an up-front explanation of the new venture, its opportunities, and the anticipated benefits to them; use visual aids; hit the highlights of your venture; don't get caught up in too much detail in early meetings with lenders and investors; avoid the use of technological terms that will likely be above most of the audience; rehearse your presentation before giving it; close by reinforcing the nature of the opportunity; and be prepared for questions.

5. Explain the "five Cs of credit" and why they are important to potential lenders and investors reading business plans.

- Small business owners need to be aware of the criteria bankers use in evaluating the creditworthiness of loan applicants—the five Cs of credit: capital, capacity, collateral, character, and conditions.
- Capital—Lenders expect small businesses to have an equity base of investment by the owner(s) that will help support the venture during times of financial strain.
- Capacity—A synonym for capacity is cash flow. The bank must be convinced of the firm's ability to meet its regular financial obligations and to repay the bank loan, and that takes cash.
- Collateral—Collateral includes any assets the owner pledges to the bank as security for repayment of the loan.
- Character—Before approving a loan to a small business, the banker must be satisfied with the owner's character.
- Conditions—The conditions (interest rates, the health of the nation's economy, industry growth rates, etc.) surrounding a loan request also affect the owner's chance of receiving funds.

[illegible]

1. Why should an entrepreneur develop a business plan?
2. Describe the major components of a business plan.
3. How can an entrepreneur seeking funds to launch a business convince potential lenders and investors that a market for the product or service really does exist?
4. How would you prepare to make a formal presentation of your business plan to a venture capital forum?
5. What are the five Cs of credit? How does a banker use them when evaluating a loan request?

[illegible]

Before you begin this section, you should review the reference material on writing a business plan on *The Business Disc*. From the menu across the top of your screen, select the "Reference" option and then click on the following document: "Business Plans and Planning." Click on "The Business Plan: Roadmap to Success," "How to Write a Business Plan," and "Business Plan for a . . . (choose the type of business you are launching). Review the concepts in these reference guides and in Chapter 11.

Why is it necessary to prepare a business plan before launching a business? Develop an outline of the business plan you will create for your company. By now, you should have created most of these components. Assemble them according to your outline.

BUSINESS PLAN PRO

Business PlanPro

This chapter on the creation of a successful business plan will complete the missing element in the *Business Plan Pro* software. Section 6, "Personnel Plan," will allow you to identify the key persons for the business. When you calculate the relevant payroll data, you will need to incorporate this information into the "Financial Plan" section.

The next step is to integrate the details of the plan with the help of section 5.4, which allows you to set the key milestones for all work to be performed.

This will be the vehicle through which all of the components of your business plan will be linked together to determine the required steps to implement the plan.

Who is responsible for each step in the plan? When is each step to begin and when does it need to be completed? ? Set deadlines for key activities, and establish budgets for each task in the plan.

Explain Milestones

Explain in detail how each of the activities are interrelated with other activities, as well as how personnel must work together to ensure the smooth integration of every element of the plan. You will often discover that each element of the plan has many more detailed subelements that become obvious as the process of building the plan takes place.

Finally, it is time to write the executive summary (remember the elevator pitch!) and finish and polish each section.

When you have completed these final steps, ask another person—preferably someone with a good business background—to read over your plan. Ask that person(s) to tell you what they were unable to understand about the plan. Their questions allow you to rewrite the plan for increased clarity.

Congratulations—YOU HAVE A BUSINESS PLAN!

BEYOND THE CLASSROOM . . .

1. Contact a local entrepreneur who recently launched a business. Did he or she prepare a business plan before starting the company? Why or why not? If the entrepreneur did not create a plan, is he or she considering doing so now? If the entrepreneur did create a plan, what benefits did he or she gain from the process? How long did it take to complete the plan? How did he or she put the plan to use during the start-up phase? Does he or she intend to keep the business plan updated? What advice does he or she have to offer another entrepreneur about to begin writing a business plan?

2. Interview a local banker who has experience in making loans to small businesses. Ask him or her the following questions:

   a. How important is a well-prepared business plan?

   b. How important is a smooth presentation?

   c. How does the banker evaluate the owner's character?

   d. How heavily does the bank weigh the five Cs of credit?

   e. What percentage of small business owners are well prepared to request a bank loan?

   f. What are the major reasons for the bank's rejection of small business loan applications?

3. Interview a small business owner who has requested a bank loan or an equity investment from external sources. Ask him or her these questions:

   a. Did you prepare a written business plan before approaching the financial officer?

   b. If the answer is "yes" to part a, did you have outside or professional help in preparing it?

   c. How many times have your requests for additional funds been rejected? What reasons were given for the rejection?