

HOW TO PREPARE A BUSINESS PLAN

A Guideline for Entrepreneurs

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I. Introduction

The business plan is your company's principal sales tool in raising capital. Before risking any capital, investors want to assure themselves you have thought through your plans carefully, and you will be able to respond effectively to problems and opportunities. They will insist on seeing your business plan before considering any investment and often will not even meet with entrepreneurs without a prior review of the business plan. So what exactly is a business plan? A business plan is a detailed description of the business, including the product, a market analysis, the management team and financial projections. A well-prepared business plan should serve two functions. First, it helps secure financing by demonstrating technical competence, market knowledge and organizational ability. Secondly, it is a valuable management tool to help establish goals, identify risks, and recognize financial and physical needs, while providing a benchmark to evaluate performance.

It is important for a plan to recognize a business's weaknesses in addition to its strengths. This increases the plan's credibility and prevents surprises for the financing firm's investment risk and opportunity. Furthermore, it allows financing firms to identify additional ways to provide added value in the form of non-financial assistance.

Elements of the following proposed business plan structure may need to be altered because of the nature of the specific business. However, all the major topics should be addressed in an appropriate fashion.

II. Summary

Many investors like to read through a one or two page summary of a business plan that highlights its important features and opportunities, and allows potential investors to determine *quickly* whether or not the venture described is of interest. The summary should contain a brief statement about the following information:

The Company and its Founders:

- ◆ When the company was founded.
- ◆ What will your business do, along with how your business is unique or different.
- ◆ Any background of the entrepreneurs that makes them particularly qualified for this business opportunity.

Market Opportunity:

- ◆ Your target market, its size, growth rate and a percentage of the market you will capture.
- ◆ You may try and include industry-wide trends or any plans for expanding the initial product line.

Products and Technology:

- ◆ Identify any technology, trade secrets or unique skills that give you a competitive edge in the market.

Financial Projections:

- ◆ After receiving the necessary financing, state your sales and profit projections for the first and second years of operations.

Proposed Financing:

- ◆ Briefly state how much equity financing you want, and how much of your company you are prepared to offer for that financing.
- ◆ State the use, or what will be made, of the capital raised.

Helpful Hints: Do not write your summary until you have written your business plan. As you draft each section, circle one or two sentences that you think are important enough to be included in a summary. Allow plenty of time to write an appealing and convincing summary, and remember the summary is the *first thing* a potential investor will be reading about you and your venture. If the summary does not grab your potential investor's interest, you may not get the chance to make a presentation, where you can convincingly rebut criticism and clear up any misunderstandings. This is one of the most important parts of your business plan.

III. The Industry, The Company and Its Product

Industry:

This section should identify the current status and major trends in the industry.

- ◆ Summarize the current state of the industry.
- ◆ Describe the seasonal nature and economic stability of the industry.
- ◆ Identify economic, social, demographic, technological or regulatory trends, which will impact the industry.

Helpful Hint: It may be beneficial to identify the source of all information used to describe industry trends.

The Company:

Describe briefly what business area your company is in, or intend to enter; what products or services it will offer and who are or will be its principal customers.

Information should include:

- ◆ Date and state of incorporation.
- ◆ Founders and their roles in the development.
- ◆ Business purpose and highlights to date, including major developments such as the introduction of new products.

Helpful Hint: If your company has been in business for several years and is seeking expansion financing, review your history and cite your prior sales and profit performance.

If your company has had setbacks or losses in prior years, discuss these and emphasize what has and will be done to prevent a recurrence of these difficulties.

Product and or Service:

This section should provide a complete, concise description of your product, including proprietary features and future development plans.

- ◆ Describe the product's function, application, appearance and quality, and include items such as brochures, pictures, engineering studies, etc.
- ◆ Describe protection of patents, copyrights, trade secrets or development time.
- ◆ Discuss remaining research and development (R&D) that must be completed before your product is placed on the market (including required time and costs).
- ◆ Describe plans for additional/future products, including R&D, development costs, technical barriers and compatibility with current products.

Target Market:

This section should provide information on your target customer and potential market size. You want to include the following information:

- ◆ Define your target market by describing the potential customers, their location, behavior, and current level of interest in the product. Also include factors that could cause changes in their attitudes.
- ◆ Describe the market's current and potential size. Provide available statistical information and/or independent sources such as customers, suppliers, or industry experts who can verify the size.

Helpful Hint: When determining the potential size, the projections should include *all* assumptions on industry trends, technical development and changing customer needs.

Competitors and Competition:

Identify all existing, direct and indirect competition, as well as potential sources of future competition.

- ◆ Name and discuss the strengths and weaknesses of all *direct* competitors.
- ◆ Compare their product with yours in terms of price, quality, service, warranties and any other important features.
- ◆ Estimate their current market share and their aggressiveness in maintaining or expanding those shares.
- ◆ Identify *indirect* competition and substitute products. Compare these to your firm and products in a similar manner as above.
- ◆ Discuss the possible development of additional competition.
- ◆ Discuss barriers to entry created by need for: large capital investment, economies of scale, technical development, lead time, established distribution channels, high switching costs, patents or any other reason.

Helpful Hint: It can be useful to make a chart or graph when comparing your strengths and weaknesses to those of your competitors.

IV. Market Plan

The Marketing plan describes how the sales projections will be attained. It should detail the overall marketing strategy that will be used to achieve the estimated market share through sales and service policies, distribution, and advertising and sales projections. It should describe specifically *what* is to be done, *how* it will be done and *who* will do it.

Overall Marketing Strategy:

- ◆ Describe your method or philosophy when determining your target customers and strategy in capturing their attention.
- ◆ Explain the alternatives for reaching these customers and identify the most efficient and effective methods to market the products.

Helpful Hint: The marketing strategy is very important to your business because it explains to your potential customers why they should buy your products over your competitors' products.

Advertising and Promotions:

- ◆ Describe the approaches the company will use to bring its product to the attention of prospective purchasers.
- ◆ The schedule and cost of promotion and advertising should be presented.

Helpful Hints: Types include direct mailings, promotional literature, newspaper ads, or the use of advertising agencies. If advertising will be a large part of your expenses, an exhibit showing how and when these costs will be incurred should be included.

Pricing Policy:

- ◆ Describe how you determined the price for each of your products.
- ◆ Compare your prices with competitors' prices.
- ◆ Explain how your price will enable you to gain acceptance for your product, increase your market share and produce profits.
- ◆ Describe the anticipated competitor reactions to your current pricing policy and any anticipated changes.

Helpful Hint: The pricing policy is one of the more important decisions you will have to make. The "price must be right" to penetrate the market, maintain a market position and – most importantly – produce a profit. Devote ample time to considering a number of pricing strategies and convincingly present the one you select.

Plans to Sell and Distribute the Product:

- ◆ Explain if distributors or sales representatives are used, describe how they will be recruited and compensated.
- ◆ Discuss the geographic areas they will cover and the exclusivity they will retain.
- ◆ Explain the marketing responsibilities they have, other than sales, and their incentives for carrying out those responsibilities. If a direct sales force is used, describe how it will be organized and controlled.
- ◆ Also discuss the size of the sales force, locations, and their salary and commission structure.
- ◆ Explain who will be contacted in the customer's organization (title or rank) and their authority or influence over the purchase decision.
- ◆ Describe the customer's decision-making process, the time involved in reaching a decision, and the resulting initial and ongoing sales effort.
- ◆ Compare your sales and distribution methods to your competition.

Service and Warranty Policies: (if applicable)

- ◆ Explain the importance of these policies to your customers.
- ◆ If distributors share in the responsibility, discuss their incentive to perform.
- ◆ Discuss the terms of any warranties and whether service will be handled by a company service organization, agencies, dealers and distributors, or factory return.

V. Operations/ Manufacturing and Management

Operations/ Manufacturing:

In this section your plan should describe the kind of facilities, plant location, space requirements, capital equipment and labor force needed to provide the company's product or service.

Location:

- ◆ Describe the location of the business and advantages and disadvantages in terms of: labor availability, required training (include cost), wage rate, labor unions, distance from customers, access to transportation, utility cost, state laws and assistance, local laws and zoning.

Facility Requirements:

- ◆ Discuss existing and required equipment, including capacity, condition, and whether it will be purchased or leased (start up).
- ◆ Describe the timing and extent of future expansion needs.

Helpful Hint: If you are an existing business, describe the facilities currently used to conduct the company's business. Include plant and office space, storage and land areas, machinery, special tooling and other capital equipment.

Strategy and Plans:

- ◆ Explain your method of manufacturing.
- ◆ Describe your raw materials or components; include your source and alternative sources, cost and related contracts.
- ◆ Provide a breakdown of both fixed manufacturing cost and variable unit cost by product.
- ◆ Describe your quality control, production control and inventory control procedures.
- ◆ Describe in detail OEM (original equipment manufacturer) and subcontracts relationship.

Management:

The management team is the key to turning a good idea into a successful business. Therefore, this section should identify the experience and skills of the key management members along with their responsibilities in this venture.

- ◆ Show an organizational chart, which indicates lines of authority, names of people currently filling positions, and positions to be filled.
- ◆ Describe the duties and responsibilities of each key member of the management team. Include a resume to show their experience and education. Show their current compensation, current share of ownership, stock options, pension plan and other benefits.
- ◆ Identify weaknesses of the management team. Discuss the availability of individuals with the necessary skills to overcome these weaknesses.
- ◆ Identify members of the Board of Directors. Discuss the skills and input they provide to the company. Disclose any investment that they have in the company.
- ◆ Identify, if any, the professional service organizations you have selected for accounting, legal, advertising, public relations, banking and any other services.

V. The Financial Plan

The financial plan is basic to the evaluation of an investment opportunity and should represent the entrepreneur's best estimate of past, present and future financial operations. Its purpose is to indicate the venture's potential profits and a timetable for financial viability. It can also serve as an operating plan for financial management of the venture.

In developing the financial plan, three basic forecasts must be prepared:

1. Profit and Loss Forecasts — Exhibit I – Income Statement

The preparation of pro forma income statements is the profit planning part of financial management. The sales forecast is critical to the earnings forecasts, as well as other projections. You have already developed the sales forecast while completing your Market Plan section, and the sales data projected should be used here.

Your next set is to budget your production cost, or operations cost, for a service business. This includes material, labor, service and manufacturing. Overhead requirements must be developed and translated into cost data. A separation of fixed and variable elements of these costs is desirable.

Sales expenses should include the costs of selling, the distribution, storage, discounts, advertising and promotion. General and administrative expenses should include management salaries, secretarial costs, and legal and accounting expenses. Manufacturing or operations overhead includes: rent, utilities, fringe benefits, telephone, etc.

Earning projections should be prepared monthly in the first year of operation and quarterly for the second and third years.

Any assumption and or risk made during preparation should be fully disclosed and explained.

2. Cash Flows Projections – Exhibit II--Cash Flow Statements

The cash flow of a new business is very important because it details the amount and timing of expected cash inflow and outflows. Usually the level of profits, particularly during the start-up years of a venture, will not be sufficient to finance operating asset needs. Moreover, cash inflows do not match the outflows on a short-term basis. The cash flows forecast will indicate these conditions and allow management to plan cash needs.

The cash forecast, given a level of projected sales and capital expenditures over a specific time period, will highlight the need for and timing of additional financing. This will also indicate when additional financing is needed, on what terms and how much will be repaid.

Cash flow projections should be made for each month of the first year operations and quarterly for the second and third years.

Once again, fully explain any assumptions made during the creation of your cash flow statement. Also, explain how these assumptions may affect the sensitivity of your cash flow in terms of operational capability.

3. Pro Forma Balance Sheets – Exhibit III --Balance Sheet

The balance sheets detail the assets required to support the projected level of operations and show how these assets are to be financed (liabilities and equity). Investors and bankers look at the projected balance sheets to determine if debt-to-equity ratios, working capital, current ratios, inventory turnover, etc., are within the acceptable limits required to justify future financing projected for the venture.

Your balance sheet should include cash that is in accounts receivable, inventory and other current assets. You should also include property, plant and equipment for other assets. Short-term bank borrowing, accounts payable, accrued expenses, accrued income taxes and other accruals should also be included. Liabilities, long-term debt, and subordinated debt should be included in current liabilities; while common stock, additional paid-in capital and retained earnings are part of total liabilities.

You may also want to include a breakeven chart. In a breakeven chart it shows the level of sales (and hence, production) needed to cover all of your cost. This includes those costs that vary with the production level (manufacturing labor, materials, sales cost), and those that do not change with production (rent, interest charges, executive salaries, etc.). The sales level that exactly equals all costs is the breakeven level for your venture.

The balance sheet should be prepared at start-up, semi-annually for the first year, and at the end of the first three years of operations.

(See Exhibits I, II, and III on the following pages for examples.)

VI. Critical Risk and Problems

The development of a business has risks and problems, and the business plan invariably contains some implicit assumptions about these risks and problems. The discovery of any unstated negative factors by potential investors can undermine the credibility of the venture and endanger its financing. By identifying and discussing the risks in your venture, you demonstrate your skills as a manager and increase your credibility with a venture capital investor.

Accordingly, identify and discuss the major problems and risk you may encounter when developing your venture. The risks that might require discussion are:

- ◆ Price cutting by competitors.
- ◆ Any potentially unfavorable industry-wide trends.
- ◆ Design or manufacturing cost in excess of estimates.
- ◆ Sales projections not achieved.
- ◆ Product development schedule not met.
- ◆ Difficulties or long lead-time encountered in the obtaining of parts or raw materials.
- ◆ Difficulties encountered in obtaining bank credit lines because of tight money.
- ◆ Larger than expected innovation and development cost to stay competitive.
- ◆ Availability of trained labor.

This list is not meant to be complete, but only indicative of the kinds of risks and assumptions that might be discussed. Indicate which of your assumptions or potential problems are most critical to the success of the venture. In order to help secure the success of your venture, describe your plans for minimizing the impact of unfavorable developments in each risk area.

VII. Community Benefits

The proposed venture should be an instrument of community and human development, as well as economic development, and it should be responsive to the expressed desires of the community.

Among the potential benefits that may merit discussion are:

Economic Development:

- ◆ Number of jobs generated in each of the first three years of the venture.
- ◆ Number of skilled and higher paying jobs.
- ◆ Ownership and control of venture assets by community residents.
- ◆ Purchase of goods and services from local suppliers.

Human Development:

- ◆ New technical skills development and associated career opportunities for community residents.
- ◆ Management development and training.
- ◆ Employment of unique skills within the community that are now unused.

Community Development:

- ◆ Development of the community's physical assets.
- ◆ Provision of needed services or products to the community.
- ◆ Improvement in the living environment.
- ◆ Community support, participation and pride in the venture.
- ◆ Development of a community-owned economic structure and decreased absentee business ownership.

IX. Overall Schedule

Provide a schedule showing the timing and interrelationships of major events necessary to launch the venture and realize its objectives. Furthermore, identify any point at which a “go” or “no go” decision must be made.

As part of this section, prepare a month-by-month schedule showing the timing of activities such as production development, market planning, sales programs, and production and operations. Sufficient detail should be included to show the timing of the primary tasks required to accomplish an activity.

Congratulations!

You now have a comprehensive business plan.

Good luck on your business venture!