Writing a Successful Business Plan

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Purpose of a Business Plan

A business plan describes the venture that you will create to exploit a concept. You are telling a story about your creation that will convince readers of the viability of your venture.

Who Should Write?

Anyone who wants to start an entrepreneurial venture. It doesn't matter if the venture is high or low tech, high or low growth, nonprofit or social, lifestyle or an entity within a large corporation or government agency. The key is to thoroughly understand the venture and plan accordingly

Why Write?

Perhaps the most important reason to write a business plan is that it requires you to engage in a rigorous, thoughtful and often painful process that is essential before you start the venture. You must answer hard questions about your venture. Why is there a need for your product or service? Who is you target customer? How is your product or service different than your competitor's? What is your competitive advantage? How profitable is the business and what are the cash flows? How should you fund the business?

Nonprofit
Is a business plan appropriate for people who are trying to start a nonprofit. How does this differ from a for-profit business? Is a business plan appropriate? In fact there is not a difference between a nonprofit and a for-profit business as far as planning is concerned. The issues are the same for both and need to be addressed..

There is a difference in one important way - a nonprofit is usually in continuous money raising mode with donors and sponsors. Unless there is an endowment, management spends a lot of their time grant writing and trying to raise funding. A business plan is an essential element in communicating with funders.

Added Benefit
An added benefit is that by virtue of going through this process you will have established a sound basis for verbally communicating the attractiveness of your venture. To be able to describe your business in a compelling manner and then to succinctly answer questions from funders is a critical skill. You can do this well only when you have made the venture a part of your soul. *Writing a Successful Business Plan* will help you do this.

What Are the Uses of a Plan?

Action Plan

A business plan may help to move you to action. You may have been thinking for years about starting a business or engaging in some venture, but the process may seem too daunting, too large and too complicated. A business plan will help you to pull apart the pieces of starting a business and examine each piece by itself. So instead of one large problem, you have a sequence of smaller problems. And by solving the small problems, the large problem is automatically solved. So writing a business plan may help to move you to action by breaking down a seemingly insurmountable task (starting a business) into many smaller, less intimidating tasks.

Road Map

Once you have started your business, a business plan is an invaluable tool to help keep you on track and moving in the direction you want to go. In the hurley-burley of daily business, it is very easy to lose sight of your objectives and goals -- a business plan may help to keep you focused. A business plan may also serve to help others to understand your vision, including suppliers, customers, employees, friends, and family.

Fund Raising

You may need outside financing to start your business. Funding sources are investors, banks, grants, government agencies, and friends and family. All of these sources will expect a well written business plan on which to base their decisions.

Sales Tool

A business plan may be used to convince people to become involved with your business. You may want and need concessions from suppliers or customers -- a business plan may help you get them. It also may be used to recruit key employees, directors and advisors. Finally, you may need to convince family members, or even yourself, that your ideas will bear fruit.

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Executive Summary

The Executive Summary of a business plan is a distillation of your entire plan, and often is the last section to be written. Despite the title, it is not written for executives, nor is it a summary of the plan. Its objective is to capture the reader's interest, so that they want to read the entire plan; even better to call you to arrange a meeting. It should be considered a chance to "sell" the reader on the business opportunity.

A first-time reader should be able to read the Summary by itself and know what your plan is all about. The Summary should stand-alone and should not refer to other parts of your plan. Remember, most readers will never get any further than your Executive Summary, so make it count!

The Executive Summary should be a maximum of two pages. Ideally you should try to get it all on one page. This is very difficult to do, but being succinct has great benefits when trying to capture the attention of investors. The summary should address at least some the following elements of the plan.

- Concept Description: Summarize the essence of your venture.
- Opportunity: Why is this a good opportunity? What is the compelling need, i.e. what problems are you solving? What is the size of your market? What are the critical trends?
- Product/Service: Describe the product or service. How will you differentiate it from the competition? How is the product or service to be produced and delivered?
- Value Proposition: What are benefits to the target customer?
- Marketing Strategy: What are the key elements of your marketing strategy?
- Competitive Advantage Who is the competition? What is your competitive advantage?
- Management: Who is the management team and why will they make a success of the venture?
- Financial: How large will the company become, i.e. what revenues will be achieved? What is the expected profitability? When will the company breakeven?
- Funding: How much funding is required? What will it be used for? What is the exit strategy?

This section should be written after you have completed the rest of the business plan.

Company Overview

The Company Overview is a one page description of the company you have founded or want to found. Upon reading this section, the reader should have a good idea of where you are now and where you are going with your company.

In addition this section will describe three essential elements of the venture: the business model, value proposition and competitive advantage. Describing them here will address upfront questions that are always in the reader’s mind.

This section should be written after you have completed the rest of the business plan.

Introduction

Write a paragraph that briefly outlines the history and current status of your company. What is the legal entity? Who owns the company now?

Vision

What is your big vision? What problems are you solving and for whom? Where do you want to be in the future? What are your guiding principles?

Mission Statement

Your mission statement is a short (one sentence to one short paragraph) inspirational statement of the purpose of your venture. Too many mission statements are vacuous exercises in ambiguity, e.g. "employees are our most valuable asset". Be sure that your mission statement is succinct and content rich, and excites your readers.

Business Model

The business model determines the economic viability of the venture. There are five elements to consider. All of these will apply to varying degrees, but most new ventures tend to innovate in one or two. Write a short description of your business model that considers the following:

1. How you will create value: provide products, transactions or service, or a mix; nature of the product/service mix and the depth and breadth of this mix; standard or customization; produce internally or outsource; sell direct or through a channel.

2. Who will you create it for: B-to-C or B-to-B; entry and future customer segments; local, national or international.
3. How you will generate revenue: how soon; how often, how many, and where will they buy; direct sales or through a channel; on what basis will they pay - cash or credit.
4. How you will make money: high or low gross profit margin; why and how prices and cost of revenue are increasing or decreasing; operating leverage.
5. How capital intensive you are: hard assets; working capital; required level of sales, marketing or development expenses.

Value Proposition

Write a brief statement of how your target customer will benefit from your product/service. Why should they care?

Competitive Advantage

Write a brief description of your sustainable competitive advantage. Consider the following:

- Internal capabilities – What are your skills, experience, resources, and tangible and intangible assets?
- Differentiation – How are you unique in the marketplace?

Product or Service Plan

Guidelines for Preparing This Section
Your business could be a product or service or both. In this section provide a detailed description of what you are providing. You should not assume that the reader is familiar with your product or service, so be sure to explain it carefully. The use of photos, schematics, drawings and renderings is an effective way to convey your offering.

Begin to sell your idea here by generating some excitement about your product/service. Be factual, but be enthusiastic. When readers have finished learning about your product/service, they should be primed for the marketing, operations and financial strategies of your venture.

Sources of Information

- Technical specification and drawings
- Prototype
- Competitor product/service matrix
- Interviews - talk to experts in the marketplace, including buyers, suppliers, sales representatives, wholesalers, distributors, and retailers.
- Customer surveys
- SWOT analysis

Features

Describe how your product or service has been designed and tailored to meet the needs of your target customer. Provide evidence that your customers need your product or service. Address the following:

Key Attributes:

- Product ventures: function (speed, taste, cost reduction) durability, installation, ease of use, packaging, etc.
- Service ventures: function, environment, reliability, responsiveness, availability, usability, etc.
- Retail ventures: the product offering, ambiance, décor and layout, location, etc. Write a one-paragraph description that evocatively describes the experience of customers using your service.
- Internet ventures: service offering, e.g. e-tailing, communication and information, data interchange, B2B buying and selling, social networking, ASP's, networking, etc.

Enhancements

- Can you enhance the product/service with a unique process, delivery methods, resources, employee skills, systems, location, strategic partnerships, etc.?
- Can you use packaging to provide functionality and facilitate the buying decision?
- How can you use sustainability to appeal to the target customer?
- Will you provide customer and tech support? Training? Delivery? Installation? Repair service? Warranty? Payment terms?

Product or Service Strategy

- What is the depth and breadth of your product/service mix? What will be introduced initially? Over the next three years? To which target customers?
- What is unique about your product/service? How will it be differentiated from your competition?
- What evidence do you have to support the demand for these features?
- What are the strengths of your product/service? Weaknesses?
- How is the product/service going to be used?
- For technology products, what are the major technical milestones that must be achieved? What is the basis for believing that they are achievable?
- Successful companies rarely have only one product or service. Describe how your offering will evolve.

Benefits

If features are about the product/service, then benefits are about the customer and should address their needs, desires and dreams. Your new bicycle may be fast and red, but these are not benefits. The benefits are that with this bike your customer can win competitions and look cool. Think about the impact on the target customer's emotions and/or pocketbook.

Key benefits:

- How do the benefits address the needs of the target customer? Think beyond a generic description of benefits, e.g.
  - Best quality: do you mean appearance, durability, reliability, etc.?
  - Good service: do you mean on-time delivery, maintenance, tech support, etc.?
  - Efficiency: do you mean less time, easier to use, greater output, fewer resources, etc.?
  - Save time: to do what? It may not always be important to save time.
  - Convenience, for what?
  - Cost savings: versus what? Does the money pile up in the basement?

- Are the benefits well understood by the target customer? What evidence do you have to support this?
- Prepare a features and benefits table. For each of the important features, describe the corresponding benefit.

Proprietary Rights

What proprietary rights do you have to the product/service? For many ventures, there are no proprietary rights and this subsection may be omitted.

- Patents, copyrights, trade secrets, non-compete agreements?
- Other proprietary knowhow or skills?

Patents
There two types of patents: first, is a design patent which protects the appearance or ornamental design of an invention. To receive a design patent your invention must have a new, original and ornamental design, and be non-obvious.

Second, is a utility patent which protects the function or method of the invention. To receive a utility patent your invention must be a process, machine, manufacture or composition; useful; novel; and unobvious to someone who has ordinary skill in the area of the invention.

In this section write a brief description of the status of your patent.
- Have you filed for a patent? What type (utility or design)? Where filed - US, EU, worldwide? Has it been issued?
- If you have not filed, but plan to do so, what evidence do you have of its patentability? Have you done a patent search?
- This area is fraught with regulatory, legal, disclosure, and financial issues? This is particularly the case with start-up ventures. You should talk to an attorney.

Trade Secrets
An alternative to the disclosure requirement, time, complexity and cost of getting a patent is to just keep the proprietary information secret. If you have unique knowledge or skills, then the strongest competitive advantage may be not to disclose it. As you would expect, this approach has its own issues, but many ventures have competed successfully this way.

Copyrights
Copyright is a legal protection of the way someone expresses their idea. Writers, composers, artists and software programmers may receive this protection. Write a brief description of the status of your copyright.

Stage of Development

Briefly describe the current status of your product or service. Where is the product in its lifecycle: conceptual, design, prototype, growing, mature, or declining? Is it ready for the market? Do you have a head start that could give you first-mover advantage? If in development, how far along is it? What obstacles remain? When will it be ready for introduction?

Market and Industry Analysis

Guidelines for Preparing This Section
The objective of this section is to prove that there is a good opportunity. Here you dispassionately describe the market you will enter and the industry in which you will compete. You may not even mention your business here, unless it is already a part of the industry. When finished with this section, you and your readers should understand the dynamics, problems, and opportunities driving your marketplace. Most important you should be able to validate the need for your product/service.

Sources of information

- Primary research
    - Interviews - talk to experts in the marketplace, including buyers, suppliers, sales representatives, wholesalers, distributors, and retailers.
    - Customer surveys
- Secondary research - internet, library, trade associations and journals.
- Supply chain analysis. Value chain.
- Samples of competitor products
- Competitor brochures, catalogs, specifications, literature, websites, advertising and promotion materials. Visit their premises.

Market Analysis

Overall Market
In this section you will define the market in which you operate, analyze the total market size and growth, and set the stage for defining the entry point. Most of the information for this section will be based on secondary research. Address the following:

- How large is the market (numbers of customers, units sold or transactions, dollar value of purchases)?
- What are the historic and future growth rates?
- What are the trends that are driving the market? How is the market changing? Consider:
    - Economic, socio-cultural, political/legal, global, environmental, demographic and technological. For example, what is the impact of aging baby boomers, single parent families, e-commerce, etc?
    - Both positive and negative developments. Even negative trends may represent opportunities, e.g. in mature markets a consolidation plan could be viable.

Addressable Market

The overall market does not necessarily represent your opportunity. Let's say you have designed a new road bicycle that is light weight and sells for $2,000. The market opportunity for this is not the entire bicycle market. You will never be able to capture a share of the market for kid's bicycles, cruisers, or mountain bikes. Therefore, the addressable market is considerably less than the overall market and is where you will focus your attention.

Segmentation

Next, identify different groups of customers who may be willing to buy your product/service to satisfy a need. A market segment is a subgroup of people or organizations sharing one or more characteristics that cause them to have similar product/service needs. Segmenting the market is the basis for deciding on your initial and future markets, product or service offering and marketing strategy. In this section you should address all of the potential markets, not just the one you plan to enter first. The following are different ways to segment the market:

- Groups of customers: demographics, psychographics, e.g. baby boomers, grandparents, environmentalists, conservatives, etc.
- Sectors: industrial (petroleum, construction, etc.), financial (retail banks, mortgage lenders, insurance, etc.), government (state, military, homeland security, etc.)
- Geography: local regional, national, international
- Product/service features: speed, performance, fragrance, etc.
- Benefits: enhance image, trend setter, improve sex life, save money, etc.
- Prices: premium, lowest cost, standard mark-up, etc.
- Distribution channel: retail, internet, door-to-door, etc.

Continuing with the bicycle example, potential segments would include athletic baby boomers with incomes greater than $150,000; first time cyclists who want to enter competitions; and courier services in large cities; and bicycle tour companies.

As with the total market, for each segment determine the market size (numbers of customers, units sold or transactions and dollar value of purchases), growth (historic and future) and trends.

Entry Point

Based on the segmentation that you did above, now describe the specific market segment that represents your best point of entry. Provide evidence that explains why this segment is attractive.

- One of the most difficult questions that you must answer is what problem are you solving for your target market, i.e. why is there a need for your product/service?

- Are there customer groups or regions that are not adequately being served? Is there a segment where customers are dissatisfied?
- Do the customers in this segment understand the benefits and are they willing to purchase?
- What future segments could you enter? Why?

Industry Analysis

In this section you will describe your competitors and how they compete. Here you must show that you understand the nature of the competition and that you can successfully enter the market.

Industry Organization

Describe how the industry is organized.

- How are goods and services produced and delivered to customers? Where are they produced? What is the level of integration?
- How do distributors, dealers, VAR's and systems integrators fit in?
- A good way to understand the industry is to analyze the value chain from beginning to end. This should give you a good understanding of the competitive forces and where you fit in.
- How do your competitors perceive themselves? Look at the websites; obtain brochures, literature, and advertisements.

Competitive Environment

Describe the competitive environment in your industry:

- How do the companies in the marketplace compete: service, quality, price, new product/service introductions, customer support, etc.?
- What is the degree of rivalry among competitors? A highly competitive industry means price competition. Most new firms can't compete on price.
- What are the gross profit margins? Net profit margins?
- What is the response of competition to new entries into the market?
- What problems and concerns do customers have with these competitors?
- Is your market place fragmented or dominated by a few companies that control a large share of the market? What is the size of the competitors? Unless these companies are SOT's (slow, old and traditional), you should not consider competing directly with them.

Barriers to Entry

Describe the barriers to entry that a new venture faces:

- Economies of scale: manufacturing, marketing, technological
- Customer loyalty: well established brands, long established relationships
- Agreements with customers, suppliers, strategic partners
- Control of the distribution channel
- Switching costs

- Capital requirements: high investment
- Access to distribution channels: exclusive distribution agreements, dominant position of competitors
- Intellectual property: patents, trade secrets, copyrights, trademarks, know-how
- Industry hostility to new entrants. Will competitors use all means to drive out new companies: pricing, legal, threats, spreading rumors.
- Government regulations: defense contracts, import restrictions
- Social conventions

Control

How much control do you have over:

- Setting prices? How are prices established in your marketplace (major competitor, industry practice, value added, etc.)? What is the bargaining strength of customers?
- Determining your costs? Can you gain an advantage through technology, process design, resource ownership or access to raw materials, low cost labor, economies of scale (difficult for a start-up), and capacity utilization. What is the bargaining strength of suppliers?
- Entering channels of distribution? What channels of distribution exist? What access do you have to existing channels of distribution? Can you create new ones? What is the bargaining strength of channel companies? Do you have to buy your way in (e.g. slotting allowances in large retail stores)?

Competition

Write a brief paragraph on each of the important competitors that describes what the company does; its position in the industry; strengths and weaknesses. Make sure that you consider all of the following sources of competition:

- Direct: companies that produce same product/service; but, they may have different strategies to compete - price, quality, selection, performance, design, tech support.
- Indirect: companies that satisfy same need with different product/services.
- Future: companies that have the capability to enter your market; they may have the same customers, but use different technology or channels.

To help you write this section, prepare a competition matrix analysis that compares your venture with the major competitors. This should be a standalone document and should be included in the appendix. Consider the following factors for each competitor. Do not be restricted to these, as each industry will have its own.

- Product/Services
    - Product/Service offering – breadth and depth

    - Quality (define the type quality)
    - Detailed analysis of the key features and benefits. Obtain samples of the competitor's products, or at the very least, specifications or drawings. For retail businesses visit the competitor's locations, observe the environment and how customers interact with the business. For internet businesses evaluate the websites.
    - Location
    - Strengths and weaknesses of the product/service
- Marketing
    - Price range and policy
    - Target market
    - Channels of distribution
    - Marketing/advertising strategy
    - Sales strategy
    - Noteworthy marketing techniques (pricing, packaging, promotions, advertising, website, distribution, etc.)
    - Market perception of the company (branding strategy)
    - Market Share
- Management
    - Key management (backgrounds and experience)
    - Strategic alliances
- Operations
    - Manufacturing and location
    - Level of integration
    - Outsourcing of production, customer/tech support
- Financial
    - Company size (revenues, number of customers, number of employees, etc.)
    - Financial history (profitability, cash flow, financial soundness)
    - Financial resources (ownership, funding, investors, etc.)
- Strengths and Weaknesses of the company

When you have completed your matrix, step back and look at it. As a standalone document, the matrix should clearly tell a story about how your offering is different from the competition.

Opportunity

Here is where you need to draw conclusions based on the Market and Industry Analysis that you have just done. Describe succinctly what the opportunity is and make a compelling case that it is attractive.

- Why have you chosen the particular entry point to start your venture?
- What is a compelling need for your product/service? Is a real problem being solved?
- Why will you will be able to compete successfully in the industry?

Marketing Plan

Guidelines for Preparing This Section
The Marketing Plan will make or break the prospects for your venture. A great idea is meaningless if you cannot find customers. Carefully drafted and logical financial projections are irrelevant if nobody buys your product. In the Marketing Plan you must explain to the reader how you will find your customers ann then convince them to buy your product/service.

Sources of information

- Market and Industry Analysis
- Customer surveys
- Interviews with experts

Customer Research

It is imperative that you do sufficient research to convince readers that customers will indeed come flocking to buy your product/service. The primary source for this information is to talk to your customers. There are many ways to achieve this: showing your product to potential customers to get reactions and suggestion; conducting focus groups; undertaking walk-up, mailed or email surveys; putting on a mock demonstration of your concept and soliciting customer feedback, and so on. Be creative in finding ways to get honest customer input about your product/service.

A well designed and conducted customer survey provides a firm foundation for the marketing plan. This may be the most credible information that you can develop to support the viability of the venture. Your research must provide evidence that answers the following questions:

- Do customers recognize that they have a need for your product or service?
- How do potential customers perceive the product/services currently in the marketplace. What is the level of satisfaction? How willing are they to change?
- Do they really understand the benefits of your product/service compared to all of the competitors in the market?
- How do customers make buying decisions?
- Why would they *not* buy your product/service?
- Are the product/service features of compelling interest to customers?
- How much would they pay?

Don't inadvertently cook the books here. You are undoubtedly enthused about your concept. Customers will pick up on your enthusiasm and often reflect it back to you, leading to erroneous conclusions about customer acceptance. So be neutral and factual as you collect data.

In this section describe the conclusions of customer surveys. Give a brief summary of how the research was conducted. A complete description of the results and methodology should be included in the appendix. If the survey is conducted properly you should be able to estimate what percent of the potential customers would buy your product/service? This is very useful when constructing the revenue model described below.

Target Customer Strategy

The objective here is to prove that you really understand how the target customer behaves and that you understand them well enough to know how to reach them. This section should follow from the work you did under the Market Analysis and should also tie to your Communications Strategy.

<u>Customer Profile</u>
Provide a profile of the customer that you are targeting to launch the product/service. Describe the characteristics that define your target customer:

- Consumers
  - Demographics (gender, sex, age, race, education, occupation or profession, income, location, etc)
  - Psychographics or life style (attitudes, beliefs, opinions, interests, values, etc.)
  - Social status (infers certain behavior: middle class values education, family activities, etc.)
- Businesses or Organizations: characterize the organizations that purchase the product/service. What industry or sector are they in: automotive, e-commerce, state governments, nonprofit, etc.? What is the size, e.g. revenues less than $100 million, 50 to 100 employees, Fortune 100 company, etc.? Where located?

<u>Buying Decisions</u>

- Describe how buying decisions are made.
  - Who makes the decision?
  - Who/what influences the decision?
- Identify the criteria that are used to make buying decisions: price, service response, quality (define what the customer means), customer/tech support, delivery time, distance to travel to make purchase, etc.
- In the case of business customers there are additional considerations. Are there different approval levels? Are decisions made centrally or decentralized? What is the budgeting cycle? At what level is the ultimate

responsibility for approving expenditures? How important are: global reach, ISO 9000, design capability, range of products, just-in-time, inventory levels, etc.?
- What is the sales cycle?
- Where does the customer purchase the product or service? Are purchases typically made from retailers, internet, directly from the supplier, through wholesalers, distributors, or other?
- When are purchases made? Daily, weekly, annually? Is there repeat business?
- How do customers pay? Do customers pay cash or by credit card? Make a down payment? Require credit?
- For business customers what are the standard payment terms? If credit terms are required, are discounts for early payment expected, e.g. 2/10, net 30 days? What is the actual payment practice?

Customer Understanding
- Where does the target customer look for information and advice, e.g. WebMD, Oprah, sales person, etc.? Describe how the target customers perceive the product/services currently in the marketplace. What is the level of satisfaction? How willing are they to change?
- What attributes and benefits of your product/service are most persuasive in getting the target customer to act?
- What does the target customer need to believe about your offering?
- Does the customer really understand what you are selling? How it will be used? Do they have a real need and can see how your product/service addresses it?
- Does your customer immediately understand the benefits that your product/service provides? If they don't, then how will you motivate them to actually spend money to buy it? Are the benefits sufficient to overcome brand loyalty and associated switching costs?
- Write a Value Proposition based on your understanding of the customer and their needs.

When profiling your target customer it is important to keep in mind that the consumer of the product/service may be different than the buyer, e.g. disposable diapers are "consumed" by babies, but are purchased by mom; cad-cam software is "used" by design engineers, but may bought by the purchasing department.

Finally, remember that the customer is always the person or entity who pays you money, but may not be the only one involved in the decision to buy. This also applies when selling through a distribution channel which is addressed next.

Channel Strategy

Describe how your product/service will reach your customers. Unless you plan to sell directly to consumers there are many different channels that you could use, depending on the industry in which you compete.

- Retailers
- Distributors, wholesalers
- Original equipment manufacturers (OEM's), system integrators and value added retailers (VAR's)
- TV infomercial
- Auctions
- Out of your trunk
- E-commerce

Should you use a multi-channel strategy? E-commerce may complement other forms of distribution.

When deciding on a distribution strategy you must consider the same buying behaviors as described above in the Target Customer Strategy and address it separately in this section of Marketing Plan. Distributors have their own criteria when deciding on whether to carry a product/service and it often has nothing to do with the actual product itself.

Positioning

Prepare a statement that positions your product/service in the minds of the target customer relative to your competitors. One way to do this is to prepare a perceptual or attribute map that uses the buying criteria decisions described above. For example, if product range and level of tech support are important criteria, then prepare an quadrant analysis that show how you compare with the competition.

Explain why you have chosen to position your company in this way. This is a great basis for showing how you will differentiate yourself.

Branding Strategy

A brand is the essence of your product/service or venture that resides in the mind of the customer. It is a key factor in differentiating your product/service. Prepare a brief description that considers the following:

- Brand identity – how do you want the customer to perceive the company and its products or services? What is the look and feel of your company as expressed in your name, logo, website, marketing materials?

- Brand experience – what should be your customer's experience when interacting with the company? What should they expect? This includes the venture's environment, ambience, employees, communication, and quality of the product/service. etc..
- Brand personality – what are the values of the company that you want to be in the mind of the consumer? How does this reflect your culture?

Pricing Strategy

Explain your pricing strategy and why it will be effective with your target customer. This information is critical to preparing the Revenue Model projections of the Financial Plan.

- Consider the following strategies for determining prices:
    - Commodity pricing
    - Set by the market
    - Supply and demand
    - Based on competitor(s) price
    - Value pricing - how much the consumer/user is willing to pay for value received
    - Payback period – depends on impact on customer profit
    - Industry rule of thumb – keystone pricing is common in retail businesses and equals purchase cost + 100% markup
    - Introductory low price to get customers to use – must be done with care as it may be difficult to raise prices later
    - Cost plus + markup – this assumes that you know your costs accurately, often not the case with new ventures
    - Razor & razor blade
    - Internet – transaction fee, advertising, intermediary commission, affiliate commission fee, subscription fee, click-throughs
    - A la carte
- List the prices for each of the products/services that you offer. How will prices change in the next five years? Why?
- What is the channel pricing, i.e. what discount does each element of the channel receive at each stage. For example, the consumer of salmon pays to the retailer $20.00 per pound; the retailer pays the wholesaler $15.00 per pound; the wholesaler pays the salmon company $10.00 per pound.
- How does your pricing strategy compare with your competitors?
- What <u>evidence</u> is there that the target customer will pay your price?

Note: A low price strategy for most startups is usually not a good idea. It is almost impossible for a startup to have the lowest costs in the industry. A new venture is inefficient at the beginning and cannot achieve the volume in the early years to have economies of scale. Only when a company has a unique design for the product/service or process that gives it a real cost advantage will a low price strategy work.

Internet Strategy

All businesses must decide how they will use the internet. Even if the internet is not a key part of your business, you must have an internet presence. This has become a specialized field and there is not enough space to discuss it here thoroughly. In this section you should provide a brief description of each strategy that you select. Consider one or more of the following:

- Websites to provide information, product descriptions and pricing; customer and technical support; conduct transactions; enhance branding
- Search engine optimization
- Social networks such as Facebook, MySpace, Twitter, Linkedin
- Chat and user groups
- Blogs
- Brand building through affiliate programs and email marketing
- Lead generation through search engines and affiliate programs
- Data collection
- Extranets to provide coordination with customers

For each strategy you choose prepare a brief action plan for at least the first two years and provide an estimate of how much it will cost. These expenses need to be included in the Sales & Marketing Expense projections of the Financial Plan.

Communication Strategy

The objective of this section is to explain how you will reach your target customers and what you will say to them It is critical that you inform your target customers about the availability of your product/service, and that you continue to communicate the benefits. Consider the following possible ways to reach your market:

- Media advertising (TV, radio, newspaper and magazines) – which media and how frequently. Remember the design cost.
- Direct response advertising (mail, email, text messaging, infomercials) – may be very effective if done well (no junk mail), but may be expensive.
- Outdoor advertising (billboards, posters, cinema, vehicles) – where advertise and how long.
- Brochures, catalogs, specifications, manuals –are very expensive. Remember the design cost.
- Point-of purchase – displays are very expensive to design, produce and distribute.
- Trade and consumer promotions

- Sponsorships and event – what events?
- Exhibitions, conferences and trade shows – which ones? Remember the design, production and transport cost of the trade booth.
- Public relations (publicity) – very effective and responds to creativity
- Viral marketing or buzz – included here for completeness. Yes, it does happen, but do not make this your only marketing action. It has been successful when it is carefully planned and implemented. It is not free.

For each strategy you choose prepare a brief action plan and provide an estimate of how much it will cost. These expenses need to be included in the Sales and Marketing Expense projections of the Financial Plan.

Sales Strategy

Nothing happens until the sale is made. Describe how your product/service will be sold:

- Personal selling? TV infomercials? Direct mail? Telemarketing?
- Who will do the selling? Company sales force? Manufacturer's representatives? Telephone solicitors?
- How will you generate leads?
- How will you recruit, train, and compensate the sales force?
- What sales commission will you pay?
- How will you support the sales effort (e.g. internal staff, service operations, etc.)?

For each strategy you choose prepare an action plan and provide an estimate of how much it will cost. These expenses need to be included in the Sales and Marketing Expense projections of the Financial Plan.

Revenue Model

Prepare a table for this section that forecasts the revenue of your venture over the next 5 years. The two approaches that you may take are top down and bottoms up.

<u>Top Down</u>
Determine your revenue drivers. These may be different for each market that you enter. Consider the following:

- Market potential
  - Size of the market in units, number of customers or transactions
  - Growth rate
  - Addressable market
- Market share

    - Penetration rate of the total market i.e., what share of the market can you reasonably expect to capture. Do not use the following logic: the market is $100 million; we only need to capture a small share, say 5%, and we will be at $5 million company. This is correct arithmetically, but sales do not happen this way.
    - You must be able to justify your assumption.
- Product and services offered
    - Range & mix
    - Roll-out strategy
    - New products or services
    - Obsolescence
- Frequency of purchase
    - Number of purchases per week, month
- Prices for each product /service line based on your pricing strategy
- Capacity utilization
    - Hours operated
    - Turns
- Channel strategy
    - Distribution channels
    - Discount

<u>Bottoms Up</u>
Provide a list of potential customers. For each one determine the amount of purchases of your product/service that are made each year. When do you expect to get an order and for how much? What evidence do you have that this assumption is reasonable, e.g. a actual purchase order, letter of intent, or verbal commitment resulting from a sales call.

The detail and thought behind this model are essential to establishing the credibility of your revenue forecast.

Operations Plan

Guidelines for Preparing This Section

The Operations section describes how you will run your business and deliver value to your customers. Operations is defined as the processes used to deliver your products and services to the marketplace. The objective is to decide how you can use operations to gain a competitive advantage.

Be sure that you carefully link the design of your operations to your marketing plan. For example, if quality is one of your competitive advantages in the marketplace, then design your operations to deliver high quality, not low costs. Remember that you will probably have to make trade-offs with your operations. It is impossible to have the lowest costs, highest quality, best on-time performance, and most flexibility in your industry all at the same time. Often, higher quality means higher costs, lower costs means less variety and less flexibility. Be careful how you make these trade-offs so that you can deliver products to the market in accordance with your marketing plan.

Both product and service businesses must address operations.

- Product Ventures: may include production (labor and materials), outsourcing, purchasing, quality control, transportation, warehouse and shipping, customer and technical support, capital expenditures for equipment and systems, engineering, research and development, etc.

- Service Ventures: may include: location, type and size of facility, recruitment and training of employees, hours of operation, computers, equipment and systems (backend systems, point of sale (POS)) furnishings, research and development, etc. If the venture also provides a product, such as a restaurant, then you need to consider the process for delivering the product/service, sourcing of materials (food), wastage, etc.

Sources of information

- Supply chain analysis
- Interviews with industry experts, process and production engineers, civil engineers
- Thomas Registry (thomasnet.com)
- Yellow pages
- Industry trade publications

Introduction

Briefly describe the process for producing and delivering your product/service This is also be a good place to include a more colorful and evocative description of your venture.

Operations Strategy

Describe how you will fulfill your marketing strategy using operations

- How will you use operations to add value for customers in your target market?
- How will you win in the marketplace on the dimensions of cost, quality (define), timeliness, and flexibility? Which dimensions will you stress and which will you de-emphasize?
- Does your process or way of doing business give you a competitive advantage e.g. Southwest Airlines or Amazon?

Scope of Operations

Describe which operations you will do in-house and which you will subcontract. Why does this make sense for your business? You should keep in-house those functions that are essential to the success of the venture. Consider the following:

- Production
- Product and process design
- Order fulfillment
- Purchasing, warehouse and shipping
- Customer service and tech support
- Installation and service in the field
- Website design and hosting

There is a tendency with entrepreneurs to think outsourcing will solve all of the operations' problems. There are clear advantages to outsourcing, such as lower initial product costs, reduced capital expenditures, lower development costs, access to expertise, and assistance in developing new markets. There are also disadvantages that need to be considered:

<u>Order size</u>
To achieve the low cost that you desire, many subcontractors have a minimum order size. Startups should be very careful in committing to purchase large quantities to achieve a low cost, as it is likely that your initial product design will change once you get feedback from your customers. The risk is that you will wind up with a lot of unsold inventory.

Lead time
The subcontractor has a lead time before it can produce and deliver your order. This may often be many weeks or months. The risk is that once the order is placed it is very difficult to change to take advantage of an unplanned increase in demand. The last thing you want to do as a startup is to tell customers that they can't have what they so dearly want to buy. Air shipping your product from your supplier is very expensive and you will have lost any cost savings. And, your Sales and Marketing people will not be happy.

Communications
What you expect to be delivered may not match the subcontractor's understanding and capabilities. Getting satisfactory answers to questions with a company which is 5,000 miles away and doesn't' speak your language is problematic. The risk is that what is delivered is not what you are expecting. It may take many long and expensive visits to prevent this.

Intellectual Property
Serious thought must be given to how much of your intellectual property do you want to divulge to a subcontractor. Yes, confidentiality agreements may address this, but the risk is that your technology is stolen and you wind up competing with your own design. The legal costs of enforcing this are well beyond the resources of most startup companies.

Exchange rate
When you outsource internationally you are exposed to exchange rate fluctuations. Even if you are quoted in your own currency, the price is likely to change the next time you purchase. Hedging is an option, but this is usually only for the short term.

Research, Development and Engineering

Describe what needs to be done to develop your product/service and what resources are required. The expenses need to be included in the Research and Development Expense projections of the Financial Plan.

- What is the current status of development? Do you have drawings? Have you developed a prototype?
- What major steps are required to develop the product or service? Provide completion dates, e.g. Month 6, Year 2.
- What technical challenges must be overcome to launch? Are the scaling issues?
- Is there intellectual property? If so, will you file a patent? Have you done a patent search? Why do you believe that your technology is patentable?
- What are your plans for testing? Alpha and beta? Are market tests required?

- What skills and experience are required? How many people? When will they be required? What is their compensation?
- What equipment and software needs to be purchased? Cost?
- Do you have to license any technology? Cost?
- Will you use outside consultants for some of the development? What is their area of expertise? Cost?

Costs and Expenditures

There are several key decisions that you will have to make that have an impact on the profitability and cash flow. Briefly describe what assumptions you have made. These expenses need to be included in the Cost of Revenue and Working Capital sections of the Financial Plan.

<u>Materials Cost</u>
Determine what materials you need to purchase and estimate the cost per unit. Identify the key vendors, suppliers, strategic partners, and associates. What arrangements have you discussed with them? What price agreements have you reached?

<u>Labor costs</u>
Determine your manpower requirements to produce and deliver the product/service. What types of employees are needed (skilled, technical, supervisory, manual, etc.)? How much will you pay them? What benefits will you provide?

<u>Production and Service Capacity</u>
Based on your sales forecast, estimate how much production or service capacity is required over the next five years. This is usually expressed as a rate per hour, day, week, month or year. For example, 1,000 bicycles per month or 150 meals per day for a restaurant. This is critical to answering the following questions:

- What type of facility is required: size, type of space (office, customer service, development, laboratories, production, warehouse and shipping).
- What days per week, hours and times will you operate?
- What capital assets do you require? Describe the major items (equipment, vehicles, buildings, fixtures, decorations, servers, computers and software, etc.) and how much each will cost. Will you lease or purchase?
- What through-put is required to meet the demand? Each venture will have unique factors that will determine this. For example, for a manufacturing company it may be pieces per machine or labor hour; for a restaurant it may be the number of tables, customers per table and table turns; for an internet company may be transactions per hour; for a medical practice it may be the number of doctors and hours spent per patient.
- Where will be bottlenecks when you grow?

Inventory

Determine how much inventory is required to support the marketing strategy. Keep in mind that in the early stages of a new business it is almost impossible to operate a just-in-time system. The order quantities are too small for suppliers to produce economically in small batches and deliver to your warehouse every day.

To estimate inventory you need to consider the lead time from your suppliers, economic order quantities and sales projections. The risk is that you will run out of stock and have very unhappy customers. Express the inventory policy in terms of days or turns.

Development Plan

Guidelines for Preparing This Section
In this section, you will outline how you intend to ramp-up your business. Assuming you have a dynamic marketing plan and customers do indeed come flocking for your product or service, you must be able to deliver it to them. The Development section is a road map of how you are going to get from where you are now to where you want to be in the future.

The objective is to identify the key steps that you need to accomplish to get the business up and running? These steps may be as routine as securing retail space, or as critical as applying for and getting a patent on key technology. Don't go into too much detail here. For example, the need to get business cards printed does not belong in a development plan.

Sources of Information

- Product/Service Plan
- Marketing Plan
- Operations Plan
- Management Plan

Development Strategy

Describe five to ten key milestones that must take place for your venture to succeed. Each of these, when completed, should theoretically increase the value of your venture. The focus should be over the next 2 to 3 years. Consider the following:

- Product and process development; prototype development
- Intellectual property
- Roll-out strategies, e.g. by regions, new products, new channels
- Marketing strategies, e.g. advertising launch, catalog mailing
- Exhibition or conference to launch a new product
- Website launch,
- Agreements with key customers, distributors or suppliers
- Strategic alliances
- Facility construction and equipment installation
- Market tests or beta tests of the product/service
- Key hires, e.g. sales manager

You will notice that funding has not been included as a milestone. Of course getting money is critical, but it is a challenge all ventures face. Investors are interested here in what needs to be done to justify their investment. Often the timing of rounds of funding is tied to the completion of key milestones.

Management Plan

Guidelines for Preparing This Section

Investors often assert that the most important attribute of a successful start-up is management. Many claim they will invest in a strong management team with a mediocre idea, but will decline to fund a weak management team with a great idea. The purpose of the Management section therefore is to convince the reader that you have a great management team to complement a great business concept. This is not the place for modesty or self-deprecation. Be honest, but highlight your accomplishments and your capabilities while mitigating any obvious shortcomings or weaknesses. For example, if you are young and inexperienced, describe how you will mitigate this by hiring people with the relevant experience; or by recruiting strong board members or advisors. When readers are finished with this section, you want them to be confident that your venture is in good hands and will be competently managed.

Sources of Information

- Resumes
- Interviews with investors and industry experts

Management Team

Describe how your company will be organized:

- Write a short paragraph on each of the founders and key managers, describing their background and experience (include resumes in the Appendix). What will be their duties and responsibilities?
    - What unique skills do they bring to the venture?
    - How will they be compensated?
- Is there a significant "hole" in the team? How do you propose to fill it?
- Provide a simple organization chart.
- Do you plan to have a stock option plan? If so, describe how the plan will be organized and how large a pool of shares is needed.
- What is the ownership structure of your company? What percent of the company does each of the founders own?

Corporate Social Responsibility

Prepare a statement on your approach to managing your venture. What do you see has your responsibilities to your stakeholders? How will you operate in a socially responsible manner?

Boards

Boards may be of great help in providing credibility and advice to a management team.

- Will you have a Board of Directors? Provide a brief description of each director's background and experience. Note, that who is on your Board of Directors is often determined by your investors.
- Will you have a Board of Advisors? This is a great area to enhance the expertise of the management team. Provide a brief description of each director's background and experience.

Competitive Advantage

Guidelines for Preparing This Section

One of the most difficult, but essential, tasks that entrepreneurs face is to explain their competitive advantage. This results primarily from an inability or unwillingness to look honestly at the competitive environment. If you have conducted an industry analysis as suggested in this Plan, then you should be in a good position to define your competitive advantage.

A second reason this is difficult is that by virtue of you being successful you will create competitors. And, they will certainly appear, as prove that there is a market and shown the competitors how to do it. How will you sustain your competitive advantage when strong competitors appear?

The reason that the Competitive Advantage appears here in the business plan is that it is based on all the decisions that you have made when writing the previous sections.

Sources of Information

Interviews
Industry Analysis
Competitive Matrix

Sustainable Competitive Advantage

When defining your competitive advantage, consider the following:

- Identify the venture's resources:
  - Financial: access to capital (equity & debt), cash reserves, government grants, etc.
  - Physical assets: plant & equipment, raw materials, location, working capital, etc.
  - Human: social, employee knowledge, experience, accumulated wisdom, labor cost and skills, etc.
  - Intangible: patents, trade secrets, know-how, copyrights, databases, etc.
  - Organizational: culture, contacts, policies, Boards of Directors & Advisors, suppliers, service providers, etc.

- Identify the venture's capabilities:
  - World class management (serial entrepreneur)
  - Well developed, high-profile, and accessible contacts that take years to build

- Sales and marketing experience
- Science or technology expertise
- Supply chain expertise
- Product/service design expertise
- Sales & distribution organization
- Total operational approach (e.g. Dell, Wal-Mart)

- What barriers <u>can you establish</u> that would restrict entry of competition?
  - Intellectual property: patents, trade secrets, copyrights, trademarks, etc
  - Switching costs to your target market
  - Customer loyalty
  - Agreements with customers, suppliers, strategic partners
  - Control of the distribution channel

The following are often mentioned as competitive advantages. All of these are not equal because they might not be sustainable or may be easily duplicated by your competitors:

- Strong Competitive Advantages
  - Intellectual property
  - Agreements with customers or suppliers
  - Long term contracts
- Credible Competitive Advantages
  - Control of costs
  - Control of prices
  - Location
  - World class management
  - Expertise
- Difficult Competitive Advantages
  - First to market
  - Development lead time
  - Brand
  - Quality
  - Service
  - Execution
  - Relationships

Risks

Guidelines for Preparing This Section
What are the risks to the successful implementation of your plans? You might wonder why you should even mention risks in the plan – won't investors be frightened off if you point out potential problems? The reality is just the opposite. All businesses face risks and investors want to be assured that you understand what they are and, most importantly, what you are going to do to mitigate them.

Identify the major risks that your venture faces. Focus on those that may have a critical impact on the success of your venture, not the ordinary operating risks faced by any business. The natural tendency is to consider what may go wrong, but equally important is what must go right.

Briefly describe each risk and then explain what steps you are going to take to mitigate it. Consider the following:

- Market
    - Size of market
    - Long sales cycle
    - Price that customers are willing to pay
    - Closing window
- Competitor's response, predatory pricing
- Strategic
    - Establishing strategic agreements
    - Volatile industry
- Operational
    - Large number of interrelated components
    - Costs target
    - Quality level
- Technology
    - Will it work?
    - Patentability
    - Time and cost to develop
    - Scalability
- Financial
    - Exchange rates
    - Interest rates
- Macro-economic
    - Government approval
    - New regulations and laws
    - State of the economy

Financial Plan

<u>Guidelines for Preparing This Section</u>
The Financial Projections section should be frosting on a cake. You've outlined a great business concept, demonstrated a real need in the marketplace, shown how you will execute your ideas, proven that your team is just right to manage the venture, and now you will show how profitable the venture will be and the cash flow. Note, however, that if your business concept is weak, or there is not a market, or if your execution is poor, or if your management team is incompetent, then your financial plans are doomed to failure. If you haven't convinced your readers by now in the strength of your concept, then they won't believe your financials.

Having said this, it is important that you have strong, well-constructed financials. If you can't show that your great concept is going to make money, your readers will quickly lose interest.

<u>Sources of information</u>

- All sections of the Business Plan: Product/Service Plan, Marketing Plan,, Revenue Model, Operations Plan, Development Plan, Management Plan.
- Financial Comparables
    - *Almanac of Business and Industrial Financial Ratios Industry*
    - *Norms and Key Business Ratios*, Moody's *Industry Review*
    - *S&P Analysts' Handbook*
- Moyes and Lawrence *Financial Projections Model*

Key Drivers

Explain in this section the two or three key drivers of the financial success of the venture. Each industry is different and your research should tell you what they are. Likely, it will be one of more of the following:

- Revenue - may be driven by market penetration, new product introductions, new store openings, a key government contract, distributor/retailer discounts, sales cycle, click thoughs, catalog response rates, restaurant table turns, etc.
- Gross Profit Margin - may be driven by your price acceptability in the market place, price increases or decreases, the purchase cost of materials, cost reductions, employee wage rates, economies of scale, productivity gains, material wastage, through-put, facility rental costs, etc.
- Large Operating Expenses - must be incurred, e.g. advertising campaign, roll out strategy, special promotions and sponsorships, sales

commissions, research and development costs of a critical project, patent application, market testing, technology license, etc.

- Customer acquisition costs - it is very important that you know this. It is determined by dividing the number of new customers in a year by the total sales and marketing expenses for the year.
- Cash Flow - there are a number of elements that make up cash flow. You should be concerned here with cash flow before any investment in the venture is made. Consider: working capital assumptions (accounts receivable days, inventory turns, and accounts payable terms), cash advances or deposits, grants, capital expenditures and depreciation, tax regulations and rates, etc.

Financial Summary

Prepare a summary of your financial projections to be included in Financial Plan. The following format is recommended:

Summary of Financial Projections
($)

	Year 1	Year 2	Year 3	Year 4	Year 5
Revenue	1,064,000	4,782,432	11,679,120	18,803,200	29,968,800
Gross Profit	443,976	3,068,970	8,602,527	13,486,786	21,776,905
EBIT	(160,931)	1,267,881	4,995,811	7,733,341	12,942,430
EBITDA	(117,550)	1,399,596	5,239,906	8,106,960	13,452,240
Net Earnings	(160,931)	789,101	2,968,686	4,613,005	7,757,058
Net Cash from Operating Activities	(276,512)	508,181	3,091,378	4,482,624	7,447,868
Capital Expenditures	280,000	500,000	550,000	650,000	750,000
Interest Income/(Expense)	0	(60,000)	(48,000)	(45,000)	(14,000)
Dividends	0	0	0	0	50,000
Cash	943,488	1,951,669	4,393,047	8,225,671	14,673,538
Total Equity	1,339,069	2,628,170	5,596,857	10,209,861	17,916,919
Total Debt	0	500,000	400,000	400,000	200,000
Growth					
Revenue Growth Rate (AAGR)		349%	144%	61%	59%
Net Earnings Growth Rate (AAGR)		Nil	276.2%	55.4%	68.2%
Ratios					
Current Ratio	7.2	4.3	5.3	5.5	6.2
Debt to Capital (LT Debt + Equity)	0.0	0.2	0.1	0.0	0.0
Profitability					
Gross Profit %	41.7%	64.2%	73.7%	71.7%	72.7%
Operating Expenses %	52.6%	37.7%	30.9%	30.6%	29.5%
Net Earnings %	-15.1%	16.5%	25.4%	24.5%	25.9%
Returns					
Return on Assets	-10.6%	20.9%	42.0%	37.0%	36.6%
Return on Equity	-12.0%	30.0%	53.0%	45.2%	43.3%
Return on Capital (LT Debt + Equity)	-12.0%	25.2%	49.5%	43.9%	42.8%

Financial Projections

Create *pro forma* income statements, balance sheets, and cash-flow projections for 5 years. These should go in the Appendix of your plan. You may want to consider using the *Financial Projections Model* developed by Frank Moyes and Steve Lawrence specifically for this task developed. This may be downloaded from the course website.

Be sure that your financial projections are in congruence with the other sections of your plan. For example, if you say you will open 3 stores in Year 2 and your financials show you opening 5 stores, readers will quickly lose confidence in your plan.

Prepare the following projections and place them in the Appendix:

- Income Statement by years for 5 years; by months for years 1-2 and by quarters for years 3-5
- Balance Sheet years for 5 years
- Cash Flow by years for 5 years; by months for years 1-2 and by quarters for years 3-5
- Break-even Analysis
- Financial Comps. To help to validate your financials, compare critical financial measures from your plan to peer companies in your industry (see the *Financial Projections Model*, COMPs section). Be able to explain and justify significant differences – differences are perfectly acceptable if they can be explained. If you cannot justify the differences, adjust your financial projections to bring them more into line with your industry.
- Assumptions. Describe the assumptions that you have made in putting together your financial forecasts. Note that this is different than the key drivers section described above. Clearly they should be consistent, but here you will go into more detail. Prepare a separate page that goes with the financial statements in the Appendix.
    - Revenue forecasts - prices, volume, discounts, margins. What happens over the 5 year period?
    - Cost of Revenue - materials costs, labor costs, major indirect expenses. What happens over the 5 year period?
    - Margins: based on the first two sets of assumptions, what is the gross margin? What happens over time?
    - Sales & Marketing expenses - numbers of people, key salaries, customer acquisition costs, commissions, exhibitions, advertising and promotion.
    - Research & Development expenses - numbers of people, key salaries, subcontract, patent applications, any major items.
    - General & Administrative expenses - numbers of people, key salaries, profit sharing, rent, legal, any major expenses.
    - Extraordinary income and expenses

- Tax rate
- Capital Expenditures - prepare a list of fixed asset items (equipment, vehicles, buildings, fixtures, decorations, computers and software, etc.) and indicate how much each will cost. What are the depreciation rate assumptions?
- Working Capital - accounts receivable, inventory, accounts payable.
- Funding - amount and timing of equity and debt, interest rate.
- Other key assumptions.

Funding

Guidelines for Preparing This Section
In this section you will determine how much funding you require and how you will use it. Then, decide what type of funding is appropriate for your venture and prepare the offering that you will make to investors or lenders.

Sources of Information

- Interviews with investors and bankers
- Interviews with grant sources and foundations
- Federal, state and local grants
- *Small Business Valuation Formula Multiples*, Bizcomps
- Financial Comparables
- Price/Earnings multiples of companies in your industry
- Valuations of recent venture capital investments in similar companies
- 5 year financial projections of the Income Statement, Balance Sheet and Cash Flow
- Moyes and Lawrence *Financial Projections Model*

Funding Requirements

The Cash Flow projection is the basis for determining the required amount and timing of funding needed to execute your plan.

- Review the Cash Flow projections to determine the amount of cash generated or required for each year.
- Review the monthly and quarterly cash flows to determine the impact of seasonality or one-time expenditures.
- Determine the amount and timing of cash infusions needed to prevent cash balances from going negative.
- Add a cash safety factor to the anticipated cash needs to protect against unexpected expenses or delayed revenue. A cushion of 20% is a good starting point in most situations.
- Develop a funding strategy that is consistent with your cash needs. Ideally funding timing should also be tied to accomplishment of major milestones which increase the value of the company (and therefore lessen the equity dilution.)
-

Funding Strategies

For most startups the only sources of funding are your own resources or friends and family. Investor funding may be difficult to obtain unless you plan to be a high growth venture. Moreover, an outside investor will own a piece of your company and you may not want to lose some control. Another option is debt financing, but this is very difficult to obtain until you a track record.

Let’s look at various sources of funding and choose which is most appropriate for you:

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<u>Equity Funding</u>

Equity is appropriate for most start-up businesses. Here are the potential sources:

- Entrepreneur’s savings and assets - if you have the personal resources it is preferable to “prove the concept” and add value to the venture before going to outside funding.
- Friends and family- suitable for smaller businesses with modest cash needs or for very early stage companies. These may be structured in a variety of ways depending on the situation. Sometimes an exit for the investors is required, but it is not unusual that the return is based on the ability to pay future dividends or buy back shares.
- Angel investors - suitable for potentially moderate sized business with moderate cash needs and good growth potential or for very early stage companies. Most angels require an exit strategy, but some may look for a cash flow payback. Sometimes angels will provide seed stage funding for high growth ventures, but it is assumed that the next round will be large and come from venture capital.
- Venture capital - suitable for high growth ventures with the potential to become very large. These businesses typically have large cash needs which are raised over several rounds. VC’s expect a clear exit strategy (will go public or be acquired) and a high rate of return. This source of funding is not appropriate for the vast majority of startups.
- Initial Public Offering (IPO) - not to be considered for startups. This will come later if you are successful.

<u>Debt Financing.</u>

Debt is appropriate for existing businesses with a financial track record and/or assets. This means that debt financing is sought after two to three years of operations. The disadvantages of borrowing money are that you incur interest expense and of course must pay it back. This is often difficult to do in the early years of a venture before it is established.

- Banks – suitable for businesses with established credit records, ongoing operations, and/or physical assets to use as collateral. You will likely have to personally guarantee the debt.
- Friends and family – may be suitable for small businesses with modest cash needs, and with the ability to make loan payments on a timely basis.
- Leases – lease rather than purchase equipment; cash flow must permit regular lease payments.
- Small Business Administration – government guaranteed loans made by banks. The criteria are less stringent than for a traditional bank loan, but the terms are more expensive.
- Credit cards, second mortgages, personal loan – may be suitable when cash requirements are small. Many entrepreneurs get started this way, but you may have to put up your first born child as collateral.

<u>Nontraditional Financing</u>
There are several sources for nontraditional funding:

- Customers
  - See a potential benefit for their company from your product/service and may agree provide cash, e.g. an advance to fund product development or pay earlier than standard credit terms.
  - May purchase an equity stake in the business to secure a needed product or reliable source of supply.
- Suppliers
  - See a potential benefit to their company and may extend special credit terms, e.g. payment in 90 days or a loan.
  - May furnish cash, technology, equipment or supplies in return for an equity stake in the business to secure initial and follow-on sales.
- Strategic partners - established players in a market are always looking for companies with interesting technology, product/services, and market positions that could benefit their business. An agreement with such a company could involve: equity funding, licensing, purchase agreements, access to their sales or distributor network, joint marketing, co-branding, and manufacturing. While there are downsides to having a strategic partner, this is a very important avenue for an early stage venture to consider. The downsides are that your partner knows exactly what you are doing; they are a potential competitor; and their involvement may frighten potential purchasers of your company.
- Grants: research grants (SBIR, Defense Dept., Homeland Security, NIH, and NSF), state economic development programs, corporations, foundations, etc. Other sources of non-traditional financing are limited only by the creativity and ambition of the entrepreneur.

Sources and Uses of Funds

Prepare a Sources and Uses statement.

- Sources of Funds - determine the amount, source and timing of funding that you have chosen for the venture: equity, debt, or non-traditional financing.
- Uses of Funds - based on the projection of the funds required and timing, describe how the funds would be used. For example:
    - Product or process design and development; web design
    - Marketing actions, e.g. major advertising campaign, catalog, grand opening
    - Intellectual property protection
    - Key hires
    - Capital expenditures, e.g. new machine, major renovation, information system
    - Working capital
- Example:

Sources and Uses of Funds

Sources:	
Equity	$1,000,000
Bank Debt	200,000
Suppliers' credit	240,000
	1,440,000
Uses:	
Losses in first year	$870,000
Working Capital	320,000
Plant & Equipment	250,000
	1,440,000

Note: Losses in the first year include product launch expenses of $500,000 and patent filing expenses of $100,000.

Offering

Describe what you are offering investors or lenders in return for their money. The Offering (or Funding Request) is where you make your pitch for money. It would be unusual to put an Offering in the actual business plan; rather this is usually discussed in the initial meetings.

For startup ventures it is very difficult to dictate the terms of the funding – this is determined by the investor or lender and is conveyed in the form of a term sheet.

The Offering has been included here for completeness sake and it is up to the entrepreneur to decide whether to include it in the business plan.

Equity:

- Describe the type of security being offered (common, preferred, warrants, etc) to the investor and what share of your company they will receive for the investment.
- What is your exit strategy? How can investors realize a return on their investment? Go public? Sell out? Operate and grow? Be prepared to address what would be the exit for the investors if the business does not develop as you hoped?

Valuation

To calculate what percentage of the company to offer, you will need to place a value on the business. It is important that you persuade investors that the deal you are offering is fair to them and is supported by the facts.

There are many approaches that may be used; you should investigate which method(s) are appropriate for your industry. They vary from sophisticated net present value models to wet your finger and stick it in the air. Find out what valuations are being used in your industry for companies of your size and stage of development. How are they determined? Your interviews with industry experts and secondary research should give you an idea of what is reasonable.

While sometimes difficult to obtain, a good starting point is the valuation of public traded companies in your industry. What are the Price/Earnings (P/E) ratios? However, this cannot be applied directly to your venture - these companies are well established, have a track record, and there is a public market for trading the shares; so you would have to reduce substantially any P/E that would be applied to your venture.

The Moyes and Lawrence *Financial Projections Model* referred to earlier has one approach for valuing ventures that you might consider.

Remember that when raising money everything is open to negotiation.

Debt

If you are seeking a loan, then you need to indicate to the lender the terms of the loan, repayment schedule, interest rate, collateral provided, and how it will be repaid. You will be required to personally guarantee the loan

Appendices

The appendices are where you should collect key documentation that supports your business plan. Include the required exhibits shown below, those that are helpful (results of marketing research), and those that assist in selling your idea (purchase orders or letters of intent from potential customers).

Make sure each appendix is clearly titled and numbered.

Don't include lots of tangential information such as newspaper clippings or tables of data unless they serve to bolster your plan. One way to deal with information that is voluminous and/or lengthy (such as a large market research study) is to summarize it, and note in the plan that the complete document is available upon request.

Required Items

- Financial Statements
  - Financial Statements
  - 5 year Income Statement
    - Annual projections
    - Monthly and Quarterly projections
  - 5 year Balance Sheet
  - 5 year Cash Flow Statements
    - Annual projections
    - Monthly and Quarterly projections
  - Break-even analysis
  - Financial assumptions
- Customer survey methodology and results
- Competition matrix
- Management resumes

Optional Items

- Development timeline
- Operations layout
- Sample menus, web pages, advertisements, etc.
- Anything else that will help to illuminate and/or sell your plan

Plan Length

Note: The written business plan should be a maximum of 20 pages and preferably less. The following is a guideline:

- Executive Summary (~1 page)
- Company Overview (~1 page)
- Product and Service Plan (~2 pages)
- Market and Industry Analysis (~3 pages)
- Marketing Plan (~4 pages)
- Operations Plan (~2 pages)
- Development Plan (~1 page)
- Management Plan (~1 page)
- Competitive Advantage (~1 page)
- Risks (~1 page)
- Financial Plan (~1 page)
- Funding Plan (1 page)
- Appendices (15 pages max)