

The Business Plan

INTRODUCTION

Starting a new business or growing an already established one requires careful planning. An entrepreneur is faced with the challenge of making decisions in an ever-changing business environment that is affected by external factors, many of them beyond the entrepreneur's direct control. The emergence of new competitors, technological advances, and changes in the macroeconomic and regulatory environments are just a few of the factors with which an entrepreneur needs to deal.

In order to build a successful and sustainable business, entrepreneurs must be forward-looking and determine what lies ahead for their company, what their future objectives and strategies are, and how they plan to achieve their goals and manage their risks. This is done through a business plan, which, unfortunately, many entrepreneurs never write. As Thomas Doherty, the senior vice president of a commercial bank, said, "Most small business owners have the plan in their head, but we would like to see a larger number who actually put it down on paper and think through some of the details—financing, competition, strengths and weaknesses, the whole strategic plan."¹ Essentially, the business plan is the evidence that the entrepreneur respects the "seven Ps of business": proper prior preparation prevents piss-poor performance.²

THE DUAL-PURPOSE DOCUMENT

For the entrepreneur, the business plan serves a dual purpose. First, it should be used as an internal document to help define a company's strategies and objectives and provide a plan for the future growth of the company. It is basically the company's "road map," laying out the planned entrepreneurial journey. The plan should not be written and filed away. It must become a living, breathing document. To be successful and experience high growth, the entrepreneur must "work the plan" by using it as a proactive tool. The business plan is an evolving, rather than an immutable, document. The entrepreneur should update and revise it at least once a year, preferably at the end of each year in preparation for the next year's operations.

In addition, an entrepreneur must always present the business plan to a potential investor(s) when raising capital. It should be noted that business plans are not always capital-raising documents. Some entrepreneurs mistakenly believe that having a business plan is synonymous with raising capital. There is an endless number of stories about business plans sent to potential investors that never provide key information, such as how much capital the entrepreneur wants, what the capital is going to be used for, and what the investor will get in terms of targeted returns. A well-articulated business plan—one in which a company's vision, strategies, financing needs, and goals are clearly outlined—will not only help an entrepreneur keep his business on track, but also make it easier for him to raise capital.

Investors are inundated with business plans but are willing to finance only a few. The old axiom "you get only one chance to make a good first impression" is especially true when you are procuring capital for your business. Typically, that one chance is through the business plan. For example, John Doerr, of the venture capital firm of Kleiner Perkins Caufield & Byers (KPCB), said, "We receive 2,500 plans per year, meet with at least 100 of those who submitted the plans and invest in about 25."³ To the investor, the business plan in most cases is the first, and often the only, representation of an entrepreneur. Therefore, it is important to have a well-written, original, and thorough business plan. A well-written business plan is one that is free of grammatical

errors, concise, and simple to understand; it clearly describes the company's product or service and tells the reader the amount of capital being sought and the way it will be repaid. A business plan with all these elements will be well received by potential investors.

BUSINESS PLAN DEVELOPMENT AND ADVICE

One venture capitalist suggests that the business plan be written or edited by the entrepreneurial team member who is the best writer and the most articulate.⁴ The result should be a document that can be understood by the average 14-year-old. In fact, after writing the plan, the entrepreneur should give it to a teenager and ask her to read it and verbally explain what the proposed product or service is, how it is going to be made available to the marketplace, how much capital is being requested, and if the management team is experienced or inexperienced, old or young. There is nothing more frustrating for a potential investor than expending valuable time reading a plan that is difficult to understand because of complicated and/or vague descriptions, poor writing, misspellings, and grammatical errors. In response to criticism that the business plan could not be understood, many entrepreneurs will say, "I know. Let me meet with you to explain it." No! The business plan should be a viable and adequate communication tool on its own, in the absence of the entrepreneur.

Another option for getting the business plan written that is available to the entrepreneur is to approach a graduate business school. Many of these schools allow their students to get academic credit for working on business projects, including writing business plans for local entrepreneurs, under the supervision of an entrepreneurship professor. Such graduate schools include New York University's Stern School of Business and Northwestern University's Kellogg School of Management. There are also numerous Web sites (e.g., *Garage.com*) and books (e.g., *Business Plans for Dummies*) that can help with basic templates. More sources are noted at the end of this chapter, in Figure 3-1.

Investors are primarily interested in knowing what they will get in return for risking their capital and whether the entrepreneur has the ability to successfully execute the plan that will deliver this

return. A well-written plan provides all the necessary information about the company and the business opportunity to enable investors to assess whether the venture is worth financing. What is the proper length of a business plan? While there is no “right” length, shorter plans tend to be better received. At the maximum, a business plan should be no longer than 30 pages.

The information contained in a business plan will vary depending on the investor(s) being solicited for financing and the type of company seeking funding. Is the financing for an acquisition or a start-up? For instance, a start-up company with a new product or service should provide data that substantiate the existence of market demand for the product or service. Also, priority should be placed on ensuring that investors are convinced that the management team has the experience and the skills necessary to launch and manage a new business venture. Bill Sutter, former general partner at Mesirow Capital, says that the three most important things he looks for in a business plan are (1) management, (2) management, and (3) cash flow.⁵

Concerning the targeted audience, if the business plan is to be presented to someone who is familiar with the industry, the company, or the management team, it may not be necessary to provide as much detailed information as it would if the plan were being presented to potential investors who had no such knowledge.

The greatest examples of this fact are the plans submitted by Intel and Sun Microsystems to Kleiner Perkins Caufield & Byers. The Intel business plan was one page, and the Sun Microsystems business plan was three pages. KPCB financed both companies.

THE BUSINESS PLAN

The development of a business plan can be a difficult, time-consuming process, but it must be done. While the general format of a business plan is standard, it should be written in a way that highlights the uniqueness of the company. The business plan should:

- Tell a complete story about the company: its management team, product or service, financing needs, and strategies, and the financial and nonfinancial goals the company expects to achieve.

- Be a balanced document, highlighting both the positive and negative aspects of the business opportunity.
- Be a forward-looking document with a time frame of at least three years.
- Be clear, concise, and organized.
- Be simple to understand.
- Provide realistic data to substantiate its claims.
- Propose the deal to the investors—what the expected returns on their investment are, and what the exit or liquidation options available to investors are.
- Provide historical and projected financial statements.

The contents of the business plan will vary depending on the type of business. For example, a research and development section should be included if the company's product is in the research and development stage or if the company has undertaken substantial research and development to get the product to market, e.g., a new drug or new technology. On the other hand, this section would not be required in a plan for a restaurant, for example. The research and development section should include a summary of the major findings, while the details should be included in the appendixes. In general, a business plan contains the following sections.

Executive Summary

In most instances, given the large number of business plans that they receive, the only section that potential investors will read thoroughly is the executive summary. This section may be the only opportunity for an entrepreneur to make a good first impression on a potential financier. Therefore, it is *the* most important section of the business plan. It has to capture all the main issues contained in the detailed business plan. It should be concise (i.e., no longer than two pages), be clear and simple to understand, and present a good summary of the most relevant information needed by potential investors.

In support of the point just stated, Barbara Kamm, while an executive at Silicon Valley Bank, said, "When bankers review a business plan, they want to see a well-written executive summary. The

executive summary is the key—it's where you distill the essence of your business."⁶ In addition to a summary of the main issues of the business plan, a good executive summary must include the following items, which are often missing from executive summaries (and sometimes even the full business plans) written by novices:

- Return on investment (ROI). This is the amount earned on an investor's capital, expressed as a percentage. For example, for an investment of \$1 million that returns \$5 million, the ROI is 400 percent.
- Internal rate of return (IRR). This is the return on investment taking into consideration the length of the investment. Using the previous example, if five years is the length of time of the investment, then the IRR is 38 percent.
- Current and potential risks.

The Company

The objective of this section is to provide information on the background of the company. The following questions should be answered:

- When was the company established, and by whom?
- Is it a start-up or a going concern?
- What type of industry is it in? Service, retail, or manufacturing?
- What market area(s) does it serve or intend to serve?
- What is the business's legal structure—sole proprietorship, corporation, or limited partnership?
- Who are the company's principals, and what are their ownership stakes? What experience and skills do they bring, and what is their involvement in the day-to-day operations of the company?
- What is the total number of employees?
- What is the revenue size of the company?
- What is the historical growth rate of the company?

Information related to the legal structure of the company should also be provided. There are advantages and disadvantages of different legal structures, as detailed here.

Sole Proprietorship

Advantages

- There is no legal expense for setting up a formal structure.
- It is easy to set up, and therefore is the most typical way small businesses start.
- All income is reported on Schedule C of the owner's personal income tax return.
- All legitimate expenses can be deducted from business income or income earned at another job.

Disadvantages

- There is unlimited personal liability for business debts.
- The business can't have employees unless you get an employer ID number to file payroll tax returns.
- You are unable to take certain kinds of business deductions.

General and Limited Partnerships

Advantages

- You save money on accounting and legal fees.
- Business income or losses go to the partners, who report it on their personal income returns.
- Business expenses and other deductions flow to the partners.
- Limited partners are not personally liable for business debts, and only in some instances are they liable for the full amount of their original investment.
- Regardless of ownership percentages, all operational decisions are made only by the general partners.

Disadvantages

- General partners are personally liable for business obligations and can be personally sued.
- Limited partners cannot participate in any decisions or they will jeopardize their liability status.

C Corporation

Advantages

- You get protection from personal liability for business debts.
- There is no limit on the number of shareholders or on stock classes or voting arrangements.
- It can provide qualified stock option and employee stock purchase plans to employees as incentives.
- There is no need to restructure prior to an IPO.

Disadvantages

- Costs of incorporation can be significant.
- The corporation is taxed as a separate entity.
- Dividend income is taxed at both the corporate and the shareholder level (double taxation).
- The corporate tax rate may be higher than the personal tax rate.

S Corporation

Advantages

- It has the same limited liability as a C corporation has.
- Profits are passed through to shareholders and taxed on an individual's return, similar to a partnership.
- Deduction of losses on a personal tax return is allowed up to the amount of the individual's cost of the company's stock, plus any loans made to the company.

Disadvantages

- The corporation can't have more than 35 shareholders.
- It can have only one class of stock, limiting the flexibility to add future investors and restrict their share of profits.
- It can't have foreigners, trusts, or other corporations as shareholders.

- It can't offer certain benefits that a C corporation can, such as medical reimbursement plans.

LLC (Limited Liability Corporation)

Advantages

- It has the ownership flexibility of a C corporation.
- There is no limit to the number of shareholders.
- You can create several classes of shareholders (founders can be entitled to a greater share of profits or of the stock's future value if it is sold to the public).
- There is no double taxation because profits are taxed only at the shareholder level.
- There is no limit to the deductibility of losses for shareholders.

Disadvantages

- If you convert a current corporation to an LLC, you might have to liquidate first and owe a big tax.
- You cannot transfer the business of your old corporation to a new LLC.

Each state has its own laws regarding how businesses must be structured and operated. Be sure to check the laws of your state or speak with a lawyer, if necessary, since many states have significant penalties for failing to register businesses properly, and many require out-of-state entities that do business within their borders to pay income or other taxes, especially if those entities have employees in the state or own property there. It is generally a good idea to incorporate in the state in which your place of business will be, but many companies also choose to incorporate in a state like Delaware, which has a well-developed body of corporate law and is generally considered more business-friendly than some other states.⁷ There are many online resources, such as www.legalzoom.com and www.incorporate.com, that will assist you in choosing a legal entity for your company, provide sample incorporation documents, and actually manage the incorporation process for you in whatever state you choose—for a fee, of course.

The Industry

It is necessary to provide the context in which the business will operate. Macroeconomic as well as industry-specific data should be presented to provide a better understanding of the overall environment in which the company will operate. This information should include:

- Macroeconomic data, such as the unemployment rate, inflation rates, interest rates, and so on, that have or will have an impact on the industry and, more specifically, on the company's operations.
- Information on regulatory changes that might have an impact on the industry or the company.
- A description of the industry—e.g., major participants, competition, and so on.
- The size of the industry—e.g., historical, current, and future trends.
- Characteristics of the industry—e.g., is it seasonal, cyclical, or countercyclical?
- Trends taking place in the industry that have an impact on the business—e.g., consolidation or deregulation.
- The key drivers in the industry—e.g., R&D, marketing, price, quick delivery, or relationships.
- Industry growth rates—past and future.
- Customer payment practices—for example, are there slow payers, such as the government or insurance companies?

The Market

This section should provide a description of the target market(s)—both primary and secondary. It's important to be specific when identifying the markets to be targeted. If the product or service is new, market research data should be included to provide information on initial and future markets. Research can be done by paying a consulting firm or by getting the information free, or at a substantially lower cost, by going to a local business school and asking

the marketing department to assign students to do it as a project for academic credit. Questions to be answered include the following:

- What are the key customer market segments? What is their size?
- Where are these market segments located? Are they regional, national, or international?
- What are the past growth rates in the market and anticipated trends?
- What are the market characteristics—seasonal, cyclical, and so on?
- Are there any anticipated changes within the primary market?
- How will each customer market segment be reached?
- How are purchasing decisions made? By whom? What are the factors that influence purchasing decisions?
- How do customers buy products—through competitive bidding, contracts, unit purchases, or some other way?
- Is there a possibility to create new customer bases? If so, how?

Product or Service Description

Investors need to know the type of product or service the company will offer to customers. They will need the following information:

- A detailed description of the product or service to be developed and marketed, including:
 - The benefits of the product or service
 - The stage of the product or service—is it an idea, a prototype, or at some other stage?
- Key product characteristics—performance, quality, durability, price, service, and so on.
- What is your differentiation strategy?
- What is your positioning strategy?
- What is your pricing strategy? Why?
- What are the chances of product obsolescence?

- Are there legal issues relating to the product or service that provide legal protection, e.g., obtained or pending patents, copyrights, trademarks, royalties, and so on?
- Other legal and regulatory issues that relate to the product or service.

Competition

Competition is a reality for every business. You should not underestimate a competitor's capabilities or overestimate your capacity to deal with them. Investors prefer to go with entrepreneurs who have a realistic assessment of their competitors and, accordingly, make a realistic plan for dealing with this competition. In this section, key competitors—direct and indirect—should be identified, and an explanation of how the company will successfully compete should be provided. Questions to be answered include the following:

- Who are the key competitors, both direct and indirect? Are they mom-and-pop or high-growth entrepreneurs? What are their strengths and weaknesses?
- Where do they operate? Are they local or national players?
- What is the market share of each?
- What are the key competitive factors—pricing, quality, performance, or something else? How does your company fare in this regard?
- What are the competitors' present market shares? What are their expected market shares? How will your company gain market share?
- Are there any barriers to entry into the market—e.g., is this a capital-intensive industry?
- What do you plan to do to mitigate this competition?

Marketing and Sales

The main question to answer here is how the product or service is going to be made available in the marketplace.

- What is your marketing strategy?
- How is your product or service going to be advertised and promoted?

- How important is marketing to the industry?
- What is the expected return on resources spent on marketing?
- What is the sales growth—historical, current, and expected in three years?
- What is the sales strategy to achieve these sales levels? At a regional or national level?
- What is the product distribution strategy? Will there be an in-house sales force or outside manufacturers' representatives? What is the sales compensation plan?
- What are the sales per employee—historical, present, future, and for the industry as a whole?

Facilities

Information provided in this section should include:

- A description of plants and their operations—size, location (e.g., rural or urban), age, and condition of plants
- Ownership or lease
- Cost estimates to run facilities
- Capital equipment required
- Condition of equipment and property
- Sales per square foot
- Insurance—coverage and name of provider(s)
- Access to public transportation
- Utilities
- Available parking for customers and employees

Operating Plan

Information should be provided to explain the day-to-day operations of the company, including the following:

Business Operations

- Days of operation and hours
- Shutdown periods
- Number of shifts

Production

- Production plans
- Key quality-control issues
- Capacity
- Utilization
- Bottlenecks
- Automation: technology versus manual
- Build to order versus build to inventory

Purchasing

- Purchasing plans
- Material resource systems
- Inventory plan
- Suppliers—local or national, proximity, single or multiple
- Product delivery
- Office: invoicing, payables, collecting
- Receiving and shipping

Labor Force

- Number of employees
- Skill levels
- Gender
- Age range
- Union versus nonunion status
- Years of service
- Compensation and salary plan
- Hourly versus exempt
- Payroll—weekly versus monthly
- Benefits
- Safety concerns
- Insurance
- Source of labor
- Productivity per employee
- Projections for labor force changes in the future

Management Team

One of the most important elements that investors look for when assessing the viability of a business venture is the strength of the management team. In this section, it is important to provide background information on the people who will be involved in the day-to-day operations of the company. From this information, the investor will try to determine whether the management team can implement the plan successfully. The ideal management team has complementary skills and expertise. Information should include:

- Names and titles of the key management personnel
- Experience, skill levels, and functional responsibilities of the key management personnel
- Anticipated changes in the management team
- Names of the principal owners
- Names of the members of the board of directors
- Names and affiliation(s) of advisors—both external and internal
- Compensation plan for key members of the management team
- Life insurance policy for the CEO or president of the company
- Succession plan
- Investments

Appendixes and Tables

Information in this section may include:

- Résumés and biographies
- Union contracts
- Leases
- Customer contracts
- Research findings

References

References should include both financial (i.e., personal and business) and character references. The idea is to make the investor as comfortable and knowledgeable as possible about the company and the entrepreneurial team. For example, when seeking bank financing, Tom and Cherry Householder, the founders of Staffing Resources, a prominent regional temporary staffing company in Illinois, submitted more than 15 letters of reference from their local police chief, from politicians, and even from competitors of their bank. It worked. They got the \$135,000 line of credit they needed to start their business.⁸

Potential Risks

An assessment of the risks currently facing the company, as well as future risks and how the company intends to mitigate these risks, needs to be presented. Some risks, such as “acts of God” (e.g., weather, major disasters, unexpected death, and so on), may not be exclusive to the company and therefore cannot be dealt with by the company. The objective is to assure the investor that the entrepreneur (1) has a realistic view of the business opportunities and the risks associated with pursuing those opportunities, and (2) has proactively thought through how to manage and mitigate those risks that can be dealt with by the company. Potential risks to consider include:

- The advent of a recession.
- The unanticipated demise or removal of the CEO.
- Unanticipated changes in key management personnel.
- Appropriateness of insurance coverage and amount required.
- The loss of a major customer(s). This issue is particularly relevant if the company’s revenues are dependent on one or a few major customers.
- Problems with suppliers.
- A potential strike or labor stoppage.
- A capital or financing shortfall.

Financial Statements and Pro Formas

Projecting the future is challenging, but it must be done. Debt and equity investors know that financial projections that go out three to

five years into the future are at best guesstimates—they have to be, as no one can predict the future (unless, of course, guaranteed future contracts have been signed). Potential investors are looking for projections grounded in defensible logic. When asked how financiers know when pro formas are correct, a venture capitalist responded, “We don’t know. In all likelihood, they will be ultimately wrong. In a start-up, it is rare for pro formas to ever match reality. We are looking for logical, defensible reasoning behind the numbers versus B.S.—‘Blue Sky’—projections simply pulled out of the air.”

DEVELOPMENT OF PRO FORMAS

Entrepreneurs should develop pro forma financial statements for all new entrepreneurial opportunities, including either a start-up or an existing company that is being purchased. Any pro forma should have figures for at least three years and three scenarios—a best-case, worst-case, and most-likely-case scenario. If only one scenario is provided, then the automatic assumption is that it is the best case because most people always put their best, not their worst, foot forward. The historical performance of a company drives the financial projections for the future of that company, unless there is other information that indicates that past performance is not a good indicator of future performance.

For example, if a new contract has been signed with a new customer, then this could be used to adjust the financial projections. Otherwise, historical numbers must be used.

For instance, Livent Inc. created major musicals such as *Joseph and the Amazing Technicolor Dreamcoat* and *Ragtime*. In 1998, the company added Chicago’s Oriental Theatre to the three other company-owned theaters in New York, Toronto, and Vancouver. Livent’s pro formas for the newly renovated Oriental Theatre were allegedly based on its success with *Joseph*, which it had staged two years earlier at the Chicago theater and in similar venues throughout the country. Livent’s projections were as follows:

Oriental Theatre

- 80 percent capacity
- 52 weeks per year
- \$40 million annual gross revenues

Before the end of 1998, Livent Inc. experienced major financial difficulties and filed for Chapter 11 bankruptcy. In bankruptcy court, an attorney for the city of Chicago, which filed a condemnation case, challenged the legitimacy of the pro formas. He argued that the \$40 million annual projected gross revenues was out of line with reality and intentionally fraudulent, given the fact that “in a recent year, a similar theater located in downtown Chicago and similar in size, reported an annual gross of just \$20,455,000!”⁹

When there are no historical data, financial projections for a start-up company can be determined in one of the following ways:

- Conduct an industry analysis and select a company within the same industry that can be used as a comparable. Where possible, review the sales figures of this company to determine its sales history from Year 1 as well as its sales growth in the past few years. Extrapolate from these figures and use the data to determine sales growth for your company. Cost figures may be determined from cost data obtained through research on, for example, a publicly owned company in the same industry.
- If sales commitments have already been secured, use these commitments to calculate the worst-case scenario. Use larger amounts to calculate the best-case and most-likely-case scenarios.
- If the product or service is completely new, market research can be undertaken to determine the overall market demand for this new product or service. Identify the size of the market and assume that the company will get a specific percentage of the total market, depending on the total number of competitors. Also, identify the potential customers and estimate the number of units that can be sold to each. It is critical that whenever possible this market research be based on both secondary research (third party market reports and/or articles from credible sources) and also primary research (direct conversations and/or surveys with potential customers in the targeted segment). This ensures that the projections are based on reliable, defensible information sources and are not just “back of the envelope” guesses.

- Alternatively, you can use specific figures for your projections, based on your own assumptions or expectations. It is important to state what these assumptions are and to justify why you believe them to be realistic.

An important issue for a start-up company to consider is to make sure that all the necessary equipment financing needs are included.

Before closing this section on pro forma development, a major warning must be given. It is important that the worst-case-scenario pro formas show that the cash flow can service the company's debt. Otherwise, procuring financing, particularly debt, may prove to be virtually impossible. This does not mean that the pro formas should be developed by working backward and "plugging" numbers. For example, if the principal payments on debt obligations are \$7,000 per month, it would be wrong to forecast the monthly revenue size, gross margins, and so on such that at least \$7,000 would be generated in after-tax cash flow to service this obligation.

No, pro formas should be developed from the top down; forecasting defensible revenues and legitimate variable costs, including labor and materials, and market-rate fixed costs such as rent. If, after developing the pro formas in this manner, it is shown that debt cannot be serviced, the action that needs to be taken is not to plug numbers, but rather to

- Reduce the amount of the debt.
- Lower the interest rates on the debt.
- Extend the terms of your loan.

All of these actions are designed to free up cash flow to service short-term debt.

Even if the entrepreneur is successful in raising capital using pro formas filled with plugged numbers, she will ultimately experience difficulties when the company's performance proves to be lower than the projections and the cash flow is not sufficient to meet debt obligations. Finally, experienced business investors such as bankers and venture capitalists can easily detect pro formas filled with plugged numbers because typically the projections are such that all the company's debt can be serviced, with maybe a little cash left over. Therefore, do not plug numbers. A pro forma development case study for Clark Company is included at the end of Chapter 5.

CHECKLIST OF FINANCIAL INFORMATION

To enable investors to better understand the information presented in this section, it is best to provide a summary of financial data and then present the detailed financial tables. Data should include:

- Historical financial statements (i.e., three to five years):
 - Cash flow statement
 - Income statement
 - Balance sheet
- Pro formas (i.e., three to five years). Financial projections (as described previously) should be provided under three scenarios—best, worst, and most-likely cases—where each scenario is based upon a different set of assumptions. For example, the worst-case scenario may assume no growth from Year 1 to Year 2, the best-case scenario may assume 5 percent growth, and the most-likely-case scenario may assume a 2 percent growth rate. A summary of the assumptions should also be provided.
- Detailed description of banking relationships for business accounts and payroll.
- The terms and rates of loans and their amortization period.
- The proposed financing plan, including:
 - The amount being requested.
 - Sources and uses of funds. [*Note:* This information is important for several reasons. First, financiers need to know how their funds are going to be used. Second, identifying other investors who are willing to provide you with resources (sources) will encourage potential investors to make a similar commitment—people find it easier to invest once they know that others have already done so. Third, value-added investors may be able to help you find alternative ways of getting resources.]
 - Payback and collateral.
 - Proposed strategy for the liquidation of investors' positions.
- Financing plan for the immediate term, short term, and long term.

- Working capital needs.
- Line of credit.
- Cash flow from operations—outside investors, sell debt, or IPO.

MOST IMPORTANT BUSINESS PLAN SECTIONS

By now, you realize that your business plan had better be compelling if your venture hopes to receive funding. Here's one more review of the "must haves" of any good business plan.

The Executive Summary

As stated earlier, the executive summary is probably the most important section of the business plan. Most potential investors don't have the time to read through a detailed plan, and therefore they read through the summary quickly to assess whether or not a venture is worth pursuing. It is extremely important to make sure that this summary is clear and explicitly highlights the factors differentiating the company that is seeking capital from its competitors. For example, the 20-page Amazon.com business plan was very successful at highlighting the fact that the book retailing industry averaged 2.7 inventory turns a year, while Amazon.com planned annual inventory turns of 70.

The Management Team

Jeff Bezos's first investors said, "We didn't invest in Amazon.com, we invested in Jeff."¹⁰ This is a perfect confirmation of the old axiom, "The investment is in the jockey, not the horse." In other words, the investment is in the team, not necessarily in the idea, product, or service. Experience has shown that having the right management team can usually be the deciding factor in the success or failure of a business venture. Remember, the venture capitalist Bill Sutter gave management as two of the three most important things that he looks for. The scarcest resource for venture capitalists today is good management. A good management team can take a mediocre idea and make it successful. Conversely, a bad management team can take an

outstanding idea and ruin it. One venture capitalist said, “In the world today, there’s plenty of technology, plenty of money, plenty of venture capital. What is in short supply are great teams.”

Investors look carefully to see who the members of the management team are, particularly if the venture is a start-up company. Do they have complementary skills, or are they a homogeneous group? Do they have relevant industry, market, or product experience? How was the leader selected? Do the team members have experience working with one another? Do they have contacts in the industry that can be leveraged? What are their track records in management, leadership, and execution?

Great teams are made up of smart people with complementary skills and styles—not everyone can deal with “in-your-face” managers—and the commonality of passion for the business, commitment to growing it rapidly and exponentially, and the experience and drive to execute quickly without quitting.

Financial Projections

Investors understand the difficulty of preparing projections of future revenues and profits. They do not expect the financial projections to be “correct”; rather, they want to see whether the entrepreneur used realistic assumptions in preparing these projections. They look at whether the analysis is logical and defensible, given the realities of the marketplace. They not only look at whether the projected cash flow can service the debt, but also ask whether the cash flow projections justify the value placed on the firm today and in the future, and also whether the company is the size they are interested in. For example, some financiers want to do business only with companies that will have at least \$200 million in revenue by Year 3. It is important to make sure that all relevant information is provided in this section and to make all the assumptions used clear.

BUSINESS PLAN DEVELOPMENT SOURCES

There are numerous books available that provide detailed information on the preparation of a business plan; you can find them in the small-business section of most major bookstores. In addition,

various companies provide consulting services on business plan development to entrepreneurs, albeit sometimes at a considerable cost. Local small-business development centers are also a good source of information and assistance. In addition, as mentioned earlier, business schools can be good sources of talented, and in most instances free, assistance. Alternatively, Figure 3-1 shows several online sources that provide detailed information on business plan development, available for free.

FIGURE 3-1

Business Plan Development Sources

Small Business British Columbia (Canada)

www.sb.gov.bc.ca

This site provides online small-business seminars, in addition to other information on business plan preparation.

Entrepreneur Magazine Online

www.entrepreneur.com

The “Starting a Business” section provides a number of business plan tips and templates for a variety of business types.

Kauffman eVenturing Entrepreneur’s Resource Center

eventuring.kauffman.org

The “Business Models and Plans” section provides original articles and an aggregation of some of the best articles on business plans.

Small Business Administration

www.sba.gov

The “Small Business Planner” section, in addition to providing a business plan template, provides other relevant information, including financing and management tips for small businesses.

Business Plan Software and Free Sample Business Plans

www.bplans.com

This site provides business plan templates and software for free and for purchase.

Venture Capital Resource Library

www.vfinance.com

This online library features free business plan templates and evaluations of business plans.

AFTER THE BUSINESS PLAN IS WRITTEN

It is very important to choose potential investors carefully—you will be establishing an important long-term relationship with them. Do your research on a potential investor(s) before sending your business plan to ensure a better rate of acceptance. Find out what types of deals the investor pursues. What is the firm's investment strategy, and what are its selection criteria? What is its success rate? How have the investors reacted during critical situations, such as a financial crisis? Do the investors just bail out, or are they in for the long haul? One good source of information in this regard is other companies that have received backing from that particular investor. Will the investors be "value-added" investors (discussed in more detail in Chapter 8), providing useful advice and contacts, or will they provide only financial resources?

It is extremely important that you know your audience so that you can limit your search to those who have an affinity for doing business with you. If your company is a start-up, then you should send the plan to those who provide "seed" or start-up capital rather than later-stage financing. For example, it would be a waste of time to send a business plan for the acquisition of a grocery store to a technology-focused lender, such as the Silicon Valley Bank. This issue will be discussed in more detail in Chapter 8, "Raising Capital."

It is always advisable to get what Bill Sutter calls "an endorsed recommendation," preferably from someone who has had previous business dealings with the investor, before submitting your business plan. John Doerr at KPCB stated, "I can't recall ever having invested in a business on the basis of an unsolicited business plan."¹¹ This endorsement will guarantee that your business plan will be considered more carefully and seriously. If a recommendation is not possible, then an introduction by someone who knows the investor will be helpful. In most instances, unsolicited business plans submitted to venture capital firms without a referral have a lower chance of getting funding than those submitted with one. If you are submitting an unsolicited business plan, it is important that you write it to be consistent with the investment strategy of the investor.

A good example of someone who did it correctly is Mitch Kapor, the founder of Lotus Development Corporation, who, in 1981, sent his business plan to only one venture capital firm.

Recognizing that his business plan was somewhat different—it included a statement that said he wasn't motivated by profit—he knew himself and his company well enough to know that not all venture capitalists would take him seriously. He carefully selected one firm—Sevin and Rosen. Why? Because this firm was used to doing business with his “type”—namely, computer programmers. They knew him personally, and they also knew the industry. It was a good decision. He got the financing he sought, even though he had a poorly organized, nontraditional plan. The way to find debt and equity providers who have a proclivity for certain types of deals will be discussed in Chapter 8.

NOTES

1. Martha Russis, “Loans Will Flow, but Less Freely than during 1998,” *Crain's Chicago Business/Small Business Report*, December 14, 1998, p. SB4.
2. *Black Enterprise*.
3. *Fast Company*, February–March 1998.
4. *Ibid.*
5. Bill Sutter, classroom presentation at Kellogg School of Management, March 10, 1999.
6. *Chicago Sun-Times*, April 4, 1996.
7. Constance Bagley and Craig Dauchy, *The Entrepreneur's Guide to Business Law*, 2nd ed. (1993), pp. 76–77.
8. *Inc.*, December 1998.
9. Laurie Cohen and Andrew Martin, “Theater Plan Not Living Up to Billing,” *Chicago Tribune*, January 15, 1999.
10. *Business 2.0*, April 2000, p. 259.
11. *The New Yorker*, August 11, 1997.