Preparing a Business Plan

THE FOURTH COMMANDMENT

PREPARE AND WORK FROM A WRITTEN PLAN THAT DELINEATES WHO IN THE TOTAL ORGANIZATION IS TO DO WHAT, BY WHEN.

Until committed to paper, intentions are seeds without soil, sails without wind, mere wishes which render communication within an organization inefficient, understanding uncertain, feedback inaccurate, and execution sporadic. Without execution, there is no payoff. The process of committing plans to paper is easy to postpone under the press of day-to-day events. In the absence of a document, fully coordinated usage of the resources of the business is unlikely. Each participant travels along a different route toward a destination of his or her own choosing. Decisions are made independently, without a map. Time is lost, energy squandered.

"Getting it down on paper seemed to help." This captures the verdict that many, if not most, successful entrepreneurs reach *after* they have toiled through the process of preparing a business plan either for a startup or for the coming year in an ongoing enterprise. But *before* such plans are put to paper, far too many business builders think, "I'm busy; I'll get to it later." Why is this so? Most people can write well enough. Why do people hesitate to commit to paper what is in their heads?

The answer is complex, but it boils down to this: What is consciously in an entrepreneur's head is usually not as complete, as good, or as promising as he or she would like to think it is. He or she may have an image but it is a long way from being a finished painting. Or, to use a different metaphor, the entrepreneur may have a melody, but it is not yet a symphony. The process of getting an idea down on paper in a business plan format can be a very creative one. It is not merely a matter of translation from head to paper, but of actually generating the complete original. This is typically a heavy undertaking. That's why the brain subconsciously whispers to itself: Procrastinate, procrastinate. It senses that there's big work ahead. Developing a symphony from a melody or a painting from an image isn't easy. Generating a written plan for a serious business venture is the same kind of creative challenge.

There are several popular misconceptions about the basic purpose of business plans, particularly those describing a brand new venture. Some people promote them as documents for raising money. Others see the plans as essentially legal boilerplate to provide entrepreneurs with "I told you sos" later on if things go sour for outside or inside investors. Still others stress the preparation of a plan as a rite of passage, a cleansing experience that tends to separate the real players from the spectators and camp followers. A perspective that includes all these

but is philosophically of much greater use is that *a business plan is a blueprint for building a business.* Few readers of this Commandment would attempt even the addition of a room to their houses without a drawing from which to work. A business plan is a word picture of what the entrepreneurial dream is, why the dream can be economically viable for those involved, and how the construction will be carried out over time.

As discussed in detail below, a business plan is most usefully thought of as an internal, operating document, not a showpiece for raising money or satisfying attorneys. A sound business plan can be an important contributor to success whenever one, two, three, or more people wish to organize and synchronize a purposeful business effort over time in order to achieve specified results. Whether or not money is raised via the plan, whether or not an attorney ever touches it, whether or not anyone but the writers ever read it, the energy invested in preparing a blueprint most often will have a high rate of return. This is true even, and perhaps especially, when as a result of the effort to put together a workable, believable plan, an idea is abandoned. It's better to cancel a flight at the gate than after takeoff.

Starting a new growth enterprise is normally a relatively high risk proposition. If the venture is successful, that is, economically viable in a projected length of time, everyone is happy, but the requirements of growth are not trivial. If the venture is unsuccessful, careers, money, reputations, spouses, good health, and even lives can be lost. Assuming the leaders of the effort have the necessary personal drive, the height of risk tends to be *inversely* proportional to the presence of two prime ingredients: 1) the directly applicable experience and managing ability of the team responsible for the venture, and 2) the thoroughness of the thinking that goes into the undertaking before it starts. To some extent, they are interchangeable.

Part of the folklore of venture capital is that it is most profitable over the longer haul to bet on good people rather than simply great concepts. "Back a quality individual before backing a surefire idea," was a motto of George Quist of Hambrecht and Quist, one of the oldest and most respected venture capital firms in the country. When pressed to list the indicators of good people or quality individuals, people with proven experience in evaluating entrepreneurs usually include the following:

- Evidence of drive and achievement-orientation
- Applicable business or technical experience
- Verifiable integrity
- Ability to communicate ideas and plans

Increasingly, a fifth indicator is finding its way onto the list, namely a propensity toward team work. The turbulent times, current and projected, generate complexity in every aspect of the business world. A variety of skills is needed to cope successfully with the myriad issues that confront any growth company of consequence. No one individual is likely to have all the skills in sufficient depth to do a quality job across the board on a sustained basis. In short, soloists are falling from favor.

A final point of perspective and perhaps clarification is that, by definition, a prospectus is "a report or statement which describes or advertises a forthcoming literary work, a flotation of stock, etc." A prospectus is not a business plan. A business plan, however, may technically be a prospectus if it is used to raise money.

In summary, after preparing a business plan, the entrepreneurial management team should have before it an agreed program—expectations, actions, and results—to which it will willingly commit itself. After reading a business plan, a director, potential investor, or other interested party should know precisely what those in-

volved intend to do, by when, with the human and financial resources called for in the plan.

Preparing a Business Plan

The length and sequence of contents in a business plan for a startup will depend upon the nature of the proposed venture. One major component that is almost always needed, however, is to describe just why, how, and when economic viability will be accomplished. Other objectives may exist and even seem to be of greater importance to the writers of a given plan, but economic viability is the one necessary condition around which the contents outlined below are molded. Without such viability, few business ventures, no matter how noble, survive for long. Self-sustaining cash flow—economic viability—is at the heart of being in business.

Why is normally addressed by first identifying precisely who outside the enterprise is interested in and qualified to buy whatever it is the enterprise will have to sell, the way it will be sold. **How** is indicated by a complete coverage of the human, production, organizational, and monetary requirements for providing the product or service on a timely and continuing basis consistent with the pricing and quality demands of a chosen marketplace. **When** is reflected by a thorough presentation of the financial implications over time of each important event called for in the plan.

In a plan that is to be read critically by others, it is also useful to have an overview or executive summary at the start. Such a section will probably be written last though it appears first. Overall, then, the contents of a basic blueprint for building a business are as follows:

Overview
Concept
Objectives
Market Analysis
Production
Marketing
Organization and People
Funds Flow and Financial Projections
Ownership

1.0 CONCEPT

As suggested earlier, there is powerful evidence that the act of committing an idea to paper is a vital step in the idea's development. This is nowhere more true than when dealing with the fundamental notion underlying the formation of a new, growth venture. By nature, new ideas are fuzzy combinations of needs, interests, capabilities, frustration, optimism, ambition, and a dozen other ingredients. Few entrepreneurs wake up one morning with an Aha! imprinted undeniably on their brains. Instant photography, Internet search engines, fail-safe computers, resoleable tennis shoes, hang gliders, fast food stores, bungee jumping, and microcomputers were not conceived with the help of lightning bolts.

In most instances, a notion or inkling takes some encouragement before it becomes a hunch. A hunch requires some massaging and mulling before it graduates into a discussion piece. A discussion piece demands conversation and research enroute to precarious classification as a full blown idea. An idea takes a lot of work to refine it into a concept upon which to build a business.

With a single, well-developed concept, a massive business empire can be built. But a single product or service is seldom enough to justify the bodily wear and tear required to launch a business that has prospects of being listed some day on a stock exchange.

Product/Service	*Possible Concept*
• Quick hamburgers	• Mass-produced restaurant food
• Part-time secretarial help	• Peak load, variable cost labor
• Microcomputer software packages	• Electronic publishing
• Better mouse trap	• Rodent control for home-makers
• Inventory control for small, auto parts retailers	• Hardware/software packages for selected vertical markets
• Solar pool heaters	• Domestic energy-transformation devices
• Buggy whips (historic example)	• Transportation stimulators
• Raw material control system for paper machines	• Productivity improvements for process industries
• Tennis shoe resoleing	• Apparel recycling

Above are a few examples to illustrate the difference between a product or service and at least one possible underlying concept. The examples do contain a touch of tongue in cheek. It is extremely *unlikely* that all the entrepreneurs responsible for the various products and services shown on the left initially elevated their basic ideas to the conceptual level on the right. The question is whether or not it would have been valuable for them to think the implications of their product or service all the way through to the customer/generic level, sooner rather than later.

There is another compelling reason to hammer a concept onto paper in black and white. The possibility of confusion, misunderstanding, and shallowness on the issue of What business are we in? is reduced. A reason-

ably refined concept can help insure that the second (and third and fourth...) product or service of a budding enterprise is synergistic and complementary to the first.

CASE H. Engineer Ed came up with a new machine that sorted bad peanuts from good peanuts on a high-volume basis. He founded a manufacturing company that did very well for him and two investors. Based on his initial success, Ed was able to attract a sizeable amount of investment money to keep on building the business. He expanded into the distribution of irradiated plastics, a field completely foreign to his early, peanut machine manufacturing and sales success. Ed's company peaked out at a modest size.

Make no misunderstanding. Ed did all right for himself financially. But he never built the big company of his dreams. Ed's eclectic, opportunistic approach has its place. So does making a big splash with a single product and then selling the embryonic company to a bigger company interested in expanding its product line. Take the money and run! Or start over again. It's a matter of what the founders are out to accomplish (See Commandment One). If you and your associates aim to build a major business, the time invested in identifying and refining your concept can have a big payoff for you.

2.0 OBJECTIVES

The Third Commandment, covered elsewhere, stresses the importance and characteristics of sound objectives. Two levels of objectives should be included in a business plan. First, the longer-term interests (intentions, objectives) of the entrepreneur(s) should be identified. Second, the operating objectives—sales, profits, market share, margins, etc.—need to be spelled out. Both levels typically require a great deal of digging and iteration. They all need to be in harmony with one another.

On the first level: What do the plan writers hope to achieve for themselves over the longer term? Most everybody, at a minimum, wants to make at least enough money to get along. But there is a huge difference in pursuing $1,000,000 in capital gains within three years and pursuing a steady stream of $75,000 net income per year for life. Neither of these two objectives holds the corner on virtue, but they *are* different. And knowing roughly what you, the plan writer, are after is important. Otherwise, critical readers of the plan don't have a reference point for the plan's feasibility.

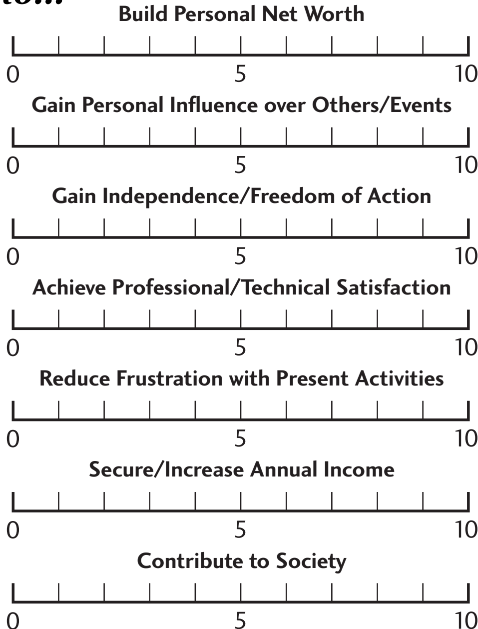
CASE I. Sandra and Kay came up with an idea for a one-stop-shopping phone service for home-repair work. In concept, they envisioned sort of a AAA for commuters who were home owners living in suburbs where people in need of a plumber, electrician, or tree surgeon usually have only the yellow pages for guidance.

The two women spent many hours fleshing out the idea. A thousand questionnaires were mailed to a randomly-selected cross section of the residents in burgeoning Contra Costra County near San Francisco. More than 10 percent of the questionnaires were answered and returned. The answers were encouraging, and the entrepreneurs wisely cross-checked the results with a variety of potential users, suppliers, and community-knowledgeable acquaintances. The end result of the research phase was the finding that the business idea appeared to be capable of supporting one, maybe two, people (owner/managers) modestly.

Is the idea a good one? Should the women proceed? It depends. This is a good example of why it is important for an entrepreneur to know his or her personal objective(s). If Sandra and/or Kay are considering entrepreneuring to get rich, this home-repair idea probably is not the way to do it. If they want to be self-employed while earning a living, it has some possibilities.

It would be a big mistake for Sandra and Kay to launch into the business with the question of personal objectives unexamined. It's an everyday occurrence to find business partnerships and young corporations on the rocks because the participants found out too late that one of them wanted to reinvest earnings and expand the business while the other preferred to take his or her share of the profits and spend it on long vacations in Europe. Proceeding with a new enterprise made up of people who have mixed motives is what keeps attorneys driving the latest BMWs.

Why are *you* interested in building a company? Personal objectives come in many shapes and sizes. Below are seven common measures along which potential starters of businesses might usefully calibrate themselves. Pick a number that corresponds to your personal level of motivation on each measure. Ten is high.



These seven measures are not meant to be the final word. A high number of points on a measure is not necessarily good. There have been hundreds of studies of whether successful entrepreneurs are born or made, renegades from society or heroes, lucky or inspired, identifiable in advance or random marriages of chance and capability. There's a small school of thought in favor of each argument, and chances are good that there will be even more theories in the days ahead as technological advances put immense capabilities at the fingertips of those who are opportunity-minded. When used as points of departure, however, the seven measures above can help an entrepreneur be honest with himself or herself and with the other contributors to the business plan, the blueprint for building the business. One thing is for certain: A business plan written by people with widely-differing or conflicting personal objectives is likely to end up as rough reading rather than a smooth description of how the enterprise will compete in a chosen industry.

The second and more obvious level of objectives that should be included in the business plan are those having to do with operating matters such as sales, profits, market share, and so on. The word objective implies *what we are going to make happen.* An objective is more than a wish. It is an *end result* to which resources–cash and people–will be allocated. Below -are some objectives lifted from a variety of business plans.

- $100,000,000 in sales by fiscal year 2007.
- Market share of 3 percent by end of third year.
- Ninety systems installed and working by 2005.
- Four thousand billable hours by the 24th month.
- Positive cash flow by end of first fiscal year.
- Shipments of 25,000 units within ten months of receipt of first order.
- Gross margins increased to 40 percent by tenth quarter of operations.
- Return on Equity of 35 percent per year, by third year.
- Positive cash flow of $225,000 by month nine after formal start of business.

In short, objectives define the construction checkpoints of the business you are planning to build. Some operating objectives will change from year to year, of course, as various checkpoints are passed and new subjects rise in importance. As objectives change, so must the supporting business plan change. The Fourth Commandment is always with you: Prepare and work from a written plan...year after year after year.

There are two trends occurring in the nature of operating objectives as we navigate the 21st century. One is that there is an increasing interest across the land in such measures as ROI (Return on Investment) and ROE (Return on Equity). In these times, it is less and less adequate to state merely how you are doing or how you expect to do in a *profit* and/or *loss* sense. Nowadays the question is more and more: How well do you expect to do with the resources or assets at your disposal? This is more of a *balance sheet* orientation.

For example, in the table ahead which company is doing better, X or Y?

	Company X	***Company Y***
Sales Last Year	*$20,000,000*	*$30,000,000*
Sales Growth over Previous Year	*50%*	*20%*
Profit percentage on Sales	*15%*	*5%*
Market Position	*Strong*	*Strong*

*   *   *   *   *

Would your answer be the same if you knew that the total assets (debt and equity) in company X were $10,000,000 and the total assets in company Y were $5,000,000?

*   *   *   *   *

Would your answer be different again if you knew that the equity in X was $3,000,000; in Y, $1,000,000? Think about it.

Obviously, your answers—based on the data given—depend on your criteria. Entrepreneurs are increasingly being confronted with the issue of the quality of the growth they are projecting. Quality typically is based on a comparison. Upon what asset or equity base is the projected growth, sales and earnings, constructed? Asset productivity is another way to think about the challenge facing managers who must deal with fluctuating interest rates, political gyrations, technological obsolescence, and certain kinds of employee shortages as they build their businesses. The use of objectives (measurable end results to be achieved) has become increasingly important as one of the few antidotes to complexity and confusion in these turbulent times.

Henry David Thoreau once said, “In the long run, men hit only what they aim at.” A business plan needs to be aimed at something that is responsive to both the plan writers’ interests and the known, basic requirements for business success in a chosen marketplace.

3.0 MARKET ANALYSIS

There is a difference between a need and a market. To use a classic example, the management of Ford Motor Company at one point in time perceived a need for a large, flashy car with a lot of gadgetry for the driver. Ford gave the world the Edsel automobile. For a variety of reasons, the perceived need did not turn out to be a market of consequence when the car was introduced. While many people liked the gadgetry, there were only a few people favorably disposed toward buying a large, flashy, futuristic car.

Here is another example. For some years now a few big manufacturers have been cultivating a need for DVD players in the home. The same is going on today with Internet devices. The cultivating is slowly paying off, and gradually the potential need is being converted around the edges into a market, i.e., a definable group of people favorably disposed toward buying the product. The purpose of the market analysis section of a business plan is to identify as precisely as possible the size, location, and characteristics of the set of people who are expected to be favorably disposed toward buying what the new enterprise expects to sell.

Please note with care the contents of the last sentence. It includes: people . . . favorably disposed toward buying. If you are planning to get money in the form of sales dollars from people not yet favorably disposed toward your new product or service, then it is important that you state as much in your market analysis. There's nothing categorically wrong with undertaking to create a market. Many entrepreneurs have done it. Doing so requires what is appropriately called missionary marketing. But it's expensive, and your capitalization will have to be sufficient to cover it. In addition, you will need the services of people skilled in such work.

CASE J. The 1970s OPEC oil price boost spawned a number of solar products companies. One of the more exciting ones had a swimming pool heating system based on some technologically-advanced collector panels. The *need* for saving pool heating dollars via solar energy seemed obvious enough. The founder had to decide if there was a market. If so, could that market be reached cost-effectively? Extensive field work indicated that there was a market for solar pool heaters that were within a certain price range. But, having identified a market, it turned out that there was no straightforward way to sell to and service it. The founder faced the hard choice of abandoning his idea or assembling a distribution system from scratch. He raised enough money to do the latter.

Once isolated, the total population of all potential buyers (consumers or corporate representatives such as purchasing agents, officers, or department heads) for a given product or service is a certain size. Call it X. Within X there are discrete subgroups called segments that vary in characteristics such as the reason for buying, financial ability to pay, and ease of reaching. Most entrepreneurs need to select a segment or a very limited number of segments upon which to concentrate available selling efforts. In the Market Analysis section of your business plan, your primary task is to describe the magnitude and nature of the business opportunity, usually in terms of segments. In later sections of your plan you will deal with how you expect to pursue the opportunity in the chosen segment(s).

What are the characteristics of markets that are attractive bets to growth-company investors? A rough outline of the criteria used by a cross section of west coast venture capitalists is as follows.

The targeted market should be:

- Over $50,000,000 in total size (annual sales volume).
- Growing at a rate significantly greater than the real GNP.
- Sufficiently fragmented or noncompetitive to allow an aggressive new entry to grow to $25,000,000 or more in sales within five years.
- Amenable to profit making by a new entry at a rate of at least 5 to 10 percent (after tax) on sales within two to three years after startup.
- Socially and politically acceptable to the business world in general so that:
    a. Traditional forms of financing such as bank loans, are available to the company once it is established.
    b. Sale of stock to the public or a larger corporation at a fair price is possible at some point in time.

This outline is, as stated, rough. There is a lot of art in making venture investments. Often the precise size of a market is not quantifiable. How big is the Internet market, for example? How big will it be in 2010? However, if a market is currently $10,000,000 in size and it is predicted to grow at 50 percent a year for ten years, there may be plenty of room for a new entry. The overriding issue is whether there appear to be enough available, profitable sales dollars to support the proposed new enterprise over a reasonable length of time so that it can develop a track record as a growth company.

One other point of great importance bears repeating. There are many good and proper reasons for entrepreneuring. Building a company to a certain size and selling it for a healthy capital gain is only one of

them. But whatever the reason, an appropriate market must exist or be developed to satisfy the top-line requirements dictated by the objectives of the primary participants. If there are inadequate sales, the top line, there will be anemic profits, if any, which is the bottom line. There are details on this in Commandment Seven.

Once plan writers have developed a comprehensive picture of the market to be pursued, the supporting or amplifying elements are relatively straightforward:

- What or who are any intermediate influences on the ultimate buyers? For example, will you have to work through dealers, distributors, Internet search engines, sales representatives, associations, purchasing agents, or retailers? What hurdles or opportunities do they present?
- What are the existing and anticipated competitive conditions? How will they affect pricing, hiring, packaging, facility location, and transportation?
- Are there important governmental influences in the chosen market, such as those affecting the five E's: energy, equality, post-Enron ethics, environment, and employment practices?

Where does one obtain market data? The list of sources is infinitely long. Libraries and the www have resources for developing a picture of an industry or market opportunity. Ideally, one or more members on the entrepreneuring team has in-depth experience in the market to begin with. If not, triple the importance of this section of your plan.

In summary, no one should try harder to understand the dynamics of the targeted marketplace than the aspiring entrepreneur, the potential new kid on the block. Ultimately, business success flows from satisfying customers (Commandment Two).

4.0 PRODUCTION

There are a variety of ways to make most products. The mix between capital equipment and people, made parts and bought parts, assemble here versus assemble there, and so forth, has to be worked out. Every decision has implications for product delivery times, cash flow, quality control requirements, and other elements of a manufacturing business such as staffing and facility requirements. Likewise, service-business management teams face early choices that often set a new business on a path from which it may be quite hard to turn later. Location is a major consideration if customers need direct access to the business. Key people, high skill or low, must be available nearby. It is hard to produce custom wood furniture without skilled woodworkers, for example. In summary, given a positive point of view about an identified market opportunity, production to capitalize on that opportunity is a key blueprint ingredient.

Production plans probably flow easiest from hard to soft, that is, from equipment lists to systems considerations and people, once a production philosophy has been established. Production philosophies generally start with a decision about where the company will position itself on the make-versus-buy continuum. There are two well-known, high-flying, publicly-held computer companies that have each exceeded $100,000,000 in sales in recent years. Neither actually manufactures more than about 15 percent of its own hardware. Eighty-five percent of every system they ship consists of vendor-supplied parts. This ratio is neither good nor bad, only different from the more traditional pattern of making what you sell. The ratio merely reflects what two different management teams have decided is best for their own enterprises.

What is best for your particular enterprise? There is no one answer. It depends most on what it is your management team does best and where money tends to get spent or made in your chosen industry. Take a look at the example below. A and B are cost distribution averages from two completely different industries and marketplaces. The management of a new company entering either industry should know the relevant averages.

Industry A Averages		***Industry B Averages***
.08	*Transportation*	*.15*
.35	*Distributors*	*.00*
.00	*Sales Representative*	*.10*
.15	*Internal Sales Force & Marketing*	*.10*
.20	*Cost of Goods Sold*	*.45*
.22	*Overhead, R&D, Profit*	*.20*
$1.00	*One Sales Dollar*	*$1.00*

On average, more than half ($.58) of industry A's dollars of revenue go to moving the product after it is in inventory. Only $.20 is spent on cost of goods sold. On average, on the other hand, companies in industry B spend $.45 on the cost of goods sold. So there is at least a preliminary argument that says a new company entering industry A might wish to allocate the bulk of its primary resources to excelling in non-manufacturing matters if it is possible to do so. An entrepreneur who can beat the $.58 average, perhaps using the Internet, may have a distinct, competitive advantage. A new company tackling industry B, in contrast, may wish to consider a production philosophy that leans more toward excelling in manufacturing, assembly, or fabrication. If the industry B entrepreneur can beat the $.45 average, he or she may have a competitive advantage.

CASE K. In 1998 three men formed a new company with $250,000 of outside capital and a concept fashioned around user-friendly inventory control systems for selected vertical markets. The company, which was selling a $30,000 item to small proprietorships which typically had annual sales of under $1,000,000, was operating in the black after its second quarter in existence. It has been immensely profitable every quarter since, and today it enjoys sales exceeding $100,000,000 a year. It has also gone public and maintained a high price/earnings ratio for some time now.

From its inception, the management in Case K minimized the amount of manufacturing done in-house. Essentially all parts were purchased. Assembly work was even subcontracted to a variety of suppliers. "I didn't want for us to have to build big parking lots on expensive real estate," said the President in an interview." Only the quality control part of production is done in-house. We have built our own staff in other areas where we think we are experts, marketing, sales, and engineering. We're happy to let others [vendors] make a buck. They can take the ebb and flow of hiring and laying off production people. They can own the parking lots."

CASE L. A new bank was formed in a medium-sized metropolitan city with a population of 100,000. It was to be the only independent bank in the area. The founders were able to attract a sizeable block of opening capital. How should that capital be allocated (beyond buying a vault!)? A fancy building and offices? Staff? Computers and systems? Automated tellers? Marketing? Product development?

Some money had to go to each category, of course, but a carefully reasoned decision was made to put the lion's share into the staff rather than into buildings, marketing, or high speed production and processing systems, where no matter how much was spent, the new bank could not excel against competition. The founders did, however, go out and hire the premier people (from other banks, naturally) in the area. The new bank exceeded its second year projections fifteen months after opening its modest doors for business.

What worked in Cases K and L are not formulas for you. The cases merely illustrate the point that a production philosophy needs to be thought through carefully before plans are made to spend money on real state, bricks, mortar, people, or equipment. Years ago Peter Drucker pointed out in his book, *Managing In Turbulent Times,* that we were rapidly becoming a nation of knowledge workers. One manifestation of that trend is a change in the historic mix in how scarce resources are allocated between sales, production, marketing, managing, and R&D activities.

Back to the business plan itself. Given a basic production philosophy, what then? It's time to get down to details:

- What processes are involved and how will they be obtained?
- What equipment is needed to support or provoke efficient, in-house operations?
- Given the above, what are the facility requirements?
- What is to be the source of raw materials, labor, supplies, and purchased parts? Who will oversee sourcing in the company?
- How will incoming inspection, quality control, packaging, transportation, and repairs be managed?
- What is the schedule of who is to do what, by when, regarding production?
- From the above, what is the budget, i.e., the timing and magnitude of expenditures?
- What will be done if the business grows much faster than expected? Or much, much slower?

As a general rule, the leaner a young enterprise is, the better. Money tied up in facilities, inventories, equipment, and other fixed costs reduces the ability of management to maneuver and adjust its plans and actions

to changing conditions. At the same time, sufficient control over the production of the customer satisfaction (product or service to be sold) is important. The best marketing program in the world will be wasted if the demand generated goes unsatisfied due to quality, cost, or delivery problems. Smart, disciplined decisions about the allocation of scarce resources are one mark of people who can excel in entrepreneuring.

5.0 MARKETING

As used here, marketing is a broad term that includes all aspects of creating and keeping customers. A business plan should reflect a detailed description of precisely how the targeted population described in the market analysis (Section 3.0) will be allowed or coaxed to exchange its money for your product and/or service on a continuing basis.

Here are some of the questions to be answered:

- How will customers' needs be identified, classified, and fed into the workings of the business?
- How will customer satisfaction be tracked?
- What methods of selling and advertising and communicating are to be used to carry the messages of your business to the intended audience(s)?
- What will make the chosen channels of distribution productive, e.g., incentive systems, packaging innovations?
- What product or service features and benefits are to be emphasized? How do they stack up against competition?
- How are credit approval, collections, and complaints to be administered?
- Who is involved in pricing decisions, and what is the basis for decisions, e.g., cost, value added, value to customer?

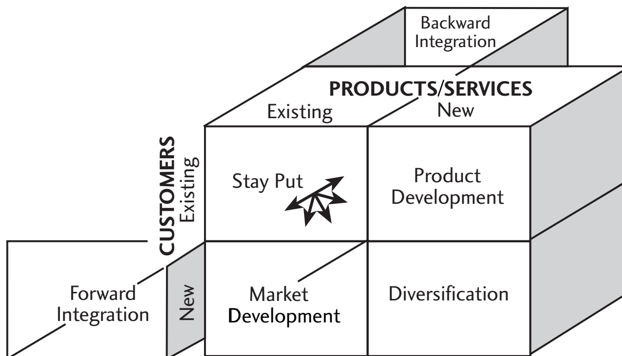
- What are the plans for the development and/or evolution of the product or service?
- What level, if any, of research activities are needed to sustain or accelerate the growth of business? [Note: Technology can be a separate and very large section of a total business plan, particularly for a technology-based venture. In such a section, the management team needs to spell out who or what will drive the needed development effort as well as what is expected to be accomplished, by when.]
- What responses by competitors are likely, if any, and how will they be countered, if at all?
- What is the schedule of who is to do what, by when, regarding marketing?
- From the above, what is the budget, the timing, and the magnitude of expenditures?
- What will be done if the business grows much faster than expected? Much, much slower than expected?

There is always an element of guesswork in predicting what is going to happen in the marketplace. This is one powerful reason why the width of management's experience base in the chosen industry is of major importance to an outsider evaluating a proposed business. The broader the base, the more valid management's expectations should be and the less likelihood there is of surprises. Candidates for entrepreneuring who have backgrounds in the steel industry are going to be less than convincing when they describe their campaign to dominate the world yogurt market.

Here is a final point of perspective under the general heading of marketing. You may have noted that the word strategy has not been used so far in this material on Preparing a Business Plan. It is a word that has been overpublicized to the point of confusion. Everything is a strategy. As a practical matter, there are potentially three levels of strategy in a growth company: Corporate, Busi-

ness, and Functional. **Corporate strategy** has to do with what business or businesses the enterprise will be in...and by exclusion, therefore, not in. Then, hopefully, each of the one or more businesses in a given corporation has a discrete **business strategy.** This is best defined as a summary statement covering what will be sold, to whom, in pursuit of the expectations that have been set for the business unit. And finally, within a given business unit, there are usually **functional strategies** for manufacturing, marketing, finance, purchasing, personnel, and so on, that summarize how objectives will be pursued.

In the marketing section of a business plan, all three levels of strategy may well be covered, but typically the emphasis is on business and functional issues. In a single business company—such as most new companies—the corporate and business strategies are one and the same anyway. Fundamentally, there are only six basic *business* strategies: Product Development, Market Development, Forward Integration, Backward Integration, Diversification, and, of course, Stay Put, i.e., continuing to sell just what you have been to your existing customers.



Basic Business Strategies for Building a Business

Once again, a statement of *business* strategy boils down to: What is to be sold, to whom. This brings us back full circle to the job of marketing. Marketing is the primary interface between an enterprise and the outside, operating environment. Young growth companies usually need smart marketing even if they do have a better mousetrap of some kind.

6.0 ORGANIZATION AND PEOPLE

People make things happen. The right people make the right things happen. Selecting and fitting the right people to key responsibilities is a continuous process that ideally starts before or at the time the business plan is developed so that the document truly reflects the input of the team that is to execute it. There are at least four layers of talent potentially active in an enterprise: A board of directors or advisors, the general management, functional specialists, and other key individuals. Some people will contribute in more than one layer.

As suggested in Commandment One, **directors** are often chosen for convenience rather than for the specific talents they might bring to the organization. This is a mistake. Qualified, interested, informed directors can be useful in guiding a company to economic viability and beyond. Properly used, a board can be an internal consulting group or a sounding board for management rather than just a legal appendage or a comfortable formality for the chief executive officer. The senior layer of talent, the board of directors or advisors, should provide perspective based on solid, related experience.

As implied earlier in this Fourth Commandment, **general management** is a prime ingredient for success in most growth companies. Managing here is defined as setting expectations and achieving results through (not with or for) others. Almost every outstanding team in any field of endeavor has one or more good

coaches, people responsible for the results who must pursue those results via their subordinates or associates. In smaller companies, most of the key people often have to wear a manager's (coach's) hat part of the time and a doer's hat the rest of the time. Under such circumstances, it's easy for the distinction between the two different kinds of work to become blurred. *Both kinds of work are necessary for successful entrepreneuring.*

When blurring occurs, it is often the managing work that gets shoved aside in the rush of day-to-day pressures to obtain orders, finish designs, produce goods, and ship things. A proper organization design can help insure that managers are in place and motivated and free to spend the necessary time on planning and supervising others in pursuit of the expectations of the enterprise, i.e., the vision, mission, and objectives.

CASE M. During the tennis boom of the mid-1970s, a number of the major tennis stars of that era started tennis-related businesses. One such business grew to several million dollars in sales from a diverse set of activities that included publishing, player management, tennis training camps, retail stores, and tournament promotion. The star-studded company lost money hand over fist. To reverse the loss, a CPA was hired to fix the company. She installed the necessary control systems and generally helped the company back to the point where it at least enjoyed positive cash flow.

After successfully completing this turn-around task, she was made President. But no other manager or supervisor was added to oversee the accounting function, which was a vital function in the rather complex operation. The CPA simply had two big jobs now instead of one: she was both the general manager and the accounting & control manager. Within a year the company was deep in the red again, and the President was both burned out...and fired.

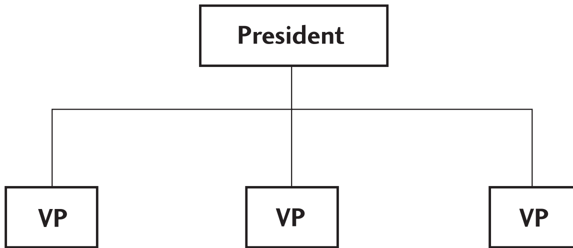
What is the moral of the story? Just below the director or advisor layer of talent, there is a layer of general

management that must be provided for in the organization design of a new venture if the founders and/or investors wish to avoid having an *ad*venture on their hands. Most everyone who has been successful at doing something (selling, engineering, programming, accounting, etc.) assumes he or she can also manage. *This is a faulty assumption.* More on this elsewhere in Commandment Five. Sound management is the second required layer of talent.

As a general rule, among the members of the management team and the board, the primary functional skills—sales & marketing, production, accounting, finance, personnel, and technology (if appropriate)—should be well represented. **Functional specialists** are the third layer of talent. It is not a problem if some functional skills are provided initially by board members, or possibly by consultants or part-timers, rather than by full-time members of the company. This condition can be altered in time as the business grows. The important point for the entrepreneur is that he or she should not try to do everything during the critical early days when there is a natural tendency to try to cover all the bases at a minimum expense. If you want to build a growth company, get the money you need to get the people you need to do what the business must have done well to succeed in an unforgiving, competitive environment. If you can't get the money you need, consider dropping or radically altering your concept. Retreat? Hell no! You merely back up to go around and try it another way.

The fourth layer of talent in most embryonic organizations is the one that contains the one or two or more **key individuals** who possess the special talents indigenous to the specific business. A semiconductor company must have a solid-state physicist. A software company must have a senior programmer. A new bank probably needs at least one banker. Case M above was critically

dependent upon tennis camp directors who could both play and manage. And a chocolate chip cookie company that started in Palo Alto, CA clearly needed a skilled baker with high-volume production experience. Sometimes the president or another officer is also the key, special talent. This works all right so long as the individual can keep his or her multiple jobs separate and well covered, either directly or via delegation.



Functional Structure

What about structure, i.e., organization design? Many new growth enterprises begin with a functional structure which contains one level of general management, a president, with functional vice-presidents filling out the team. There are other possibilities, of course. The vice-presidents could be responsible for products or geographic areas, for example, instead of functions, but usually such profit center designs, with their multiple layers of general management, make more sense later. For a new company intent on growth, a simple functional organization with simple titles, if any, and an articulated policy of organizational flexibility is probably the best approach. In the business plan, then, the writer or writers identify the starting point. The purpose of the initial design is to support the business strategy of the enterprise. In most cases, the design should be purposefully changed over time as the enterprise changes in size and complexity.

Given a structural starting point, here are the major supporting details that can usefully be included under Organization and People in a business plan:

- Who (resumes) is accountable to whom, for what?
- What pay, incentives, benefits, and promotion sequences will be used to attract, stimulate, and hold on to desired people?
- How will salaries be determined and administered over time?
- When and where will various people be added to the organization over, say, the first year or so?
- From the above, what is the budget, the timing, and the magnitude of expenditures?

Capable people who understand what they are to accomplish and who are motivated to invest their energies in the enterprise are the basic building blocks of entrepreneuring. Increasing attention is being paid today to the people side of business. "Our perspective is that organizations are organic, not mechanical or hydraulic," say authors Pascale and Athos in their framebreaking book, *The Art of Japanese Management.* The development of a positive, energetic, corporate culture is best begun when an organization is small. The amount of thought put into the organization design is frequently a useful, early indicator of the amount of attention that will be paid to people factors in the equation for success, however defined.

7.0 FUNDS FLOW AND FINANCIAL PROJECTIONS

Startup money (initial capitalization) is the temporary glue that holds the building blocks of a new company together until the merit of the company's product or service is widely enough recognized and valued in the

marketplace to generate the earnings needed to support and build the business. The amount and timing of the startup money needed is derived primarily from the production, marketing, organizational, and perhaps technology sections of the business plan discussed earlier. Many new companies do not require startup money from outside investors. Some do.

Entrepreneurs often worry about how much of their companies they will have to give up to investors before they worry about how much glue they need to successfully launch the enterprise. This is backward thinking. A healthier perspective goes something like this: 1) The needs of the business should dictate the amount and timing of the capital required. It probably takes less to start a consulting practice than it does to found a toy company. 2) If the amount required exceeds what the founder(s) can provide, he, she or they should consider raising the incremental money needed from investors. It is usually better to bring in outside money than to start short, i.e., start thinly capitalized. And it is often easier to raise money before starting operations than to try to do so after starting when cash gets tight. 3) For those with growth-company ambitions, it is better to own a small piece of a big pie than vice versa. Money is a continuing need in a growth company. The aspiring entrepreneur who is unable to appreciate (and/or raise) money may be better off setting more modest expectations for himself or herself. 4) Recognize that you are not giving up anything when you bring in outside money, you are selling a piece of the company. 5) If you decide to use them, solicit buyers (investors) who are in synch with your objectives. (See Commandment One.) Be well prepared to negotiate the price. Do your homework.

The amount of money you are able to get for a portion of your company will depend on:

- How much money is needed.
- The magnitude and shape (rewards/risks) of the opportunity.
- The background of the management team.
- The quality of the business plan.
- The chemistry between the individuals involved.
- What's going on in the world at the time of the decision.

It's academic to worry about "giving up an arm and a leg" until you have crystallized the size of the transaction. A detailed, realistic cash flow projection is the basic technique for determining the needs of a growth business.

A cash flow projection consists of three fundamental elements: cash in, cash out, and timing. A skeleton projection is shown on the next page.

Look first at the bottom item, q., labeled Cumulative Cash Position. This is the primary line to heed. An enterprise cannot operate long with zero cash, and it certainly can't grow. In many respects, a complete Cash Flow Projection is a quantitative summary of how you and your associates intend to build the enterprise. Item q. is your fuel gauge. [Note: Today there are excellent cash flow projection software programs available. By using such a program, prospective entrepreneurs can play what if with their cash flow planning.]

The Periods at the top can be months, quarters, or years. Typically, a business plan for a substantial enterprise will show months for the first year or two, quarters for an additional year or two, and years for the balance up to a total of four or five years. While few readers expect the later years' projections to turn out to be 100 percent accurate, it is important that growth company managers think through their opportunity beyond a year or so, even if there are major unknowns.

Outline: Cash Flow Projection

Periods		*1*	*2*	*3 . . TOTALS*
Dates		*Jan.*	*Feb.*	*Mar.*
Cash In				
a.	*Units Sold*			
b.	*Units Shipped/Provided*			
c.	*Price/Unit*			
d.	*$ of Net Sales*			
e.	*Sales $ Rec'd*			
f.	*Discounts, Commissions Paid*			
g.	*Net Cash In*			
Cash Out				
h.	*Cost of Goods Sold*			
	1. Purchases			
	2. Materials			
	3. Labor			
i.	*Management*			
j.	*Marketing*			
k.	*Administration*			
l.	*Rent, Utilities, Phone*			
m.	*Net Cash Out*			
n.	*Cash Flow/Period*			
o.	*Starting Cash*			
p.	*Net Cash Flow*			
q.	*Cumulative Cash Position*			

Items a. and b., Units Sold and Units Shipped/Provided, are increasingly important indicators of the reasonableness of a given plan. The units can be units of service, contracts, boxes of product, gallons, whatever is the basic element of transaction in the business. If the rate at which units move is suspect, the validity of the entire cash flow will be open to question.

Picture this. Four people conceive an idea for a new company and prepare the following as part of their cash flow projection. How would you evaluate the figures shown?

	Year 1	Year 2	Year 3
Units Sold	1000	2,300,000	9,000,000
Units Shipped	1000	2,000,000	8,000,000

	Yes	No
A. Looks like an exciting growth opportunity.	____	____
B. The year-to-year increases are quite sizeable, particularly between year one and year two.	____	____
C. The management will need to know a lot about marketing and production.	____	____

Of course it's hard to make a determination without knowing what makes up the units. If the units were toothpicks, one conclusion might be reached. If the units are aluminum wheelbarrows, another conclusion. Regardless of the units, however, choice B. is Yes, and probably so is choice C. Any management that is going to increase output by 2000 times over a twenty-four month period (Year 1-2) has its work cut out for it. Optimism is important in entrepreneuring, alongside realism.

Returning to the Outline: Cash Flow Projection, items c. through m. are straightforward. For a complicated business, e.g., one with a lot of engineering or high science, the number of line items included in the cash in and cash out calculations might number 100 or more. The important thing is to identify all the significant cash sources and uses. Doing so will reduce, but not eliminate, downstream (later) surprises.

Item n. is item g. minus item m. This Cash Flow/Period is the *actual* cash in hand at the end of the particular month, quarter, or year. [Note: the difference between items d. and e. is that d. is the figure for invoices mailed; e. is the cash actually received from customers. If your customers take sixty days to pay you, there is a sixty-day lag between sales and receipts.]

OPERATING STATEMENT

	20XX	20XY	20XZ
Sales			
Cost of Sales			
Gross Margin			
Marketing			
Management			
Engineering			
Administration			
Other			
Operating Profit			
Taxes			
Net Profit			

BALANCE SHEET

	20XX	20XY	20XZ
Assets			
Cash			
Inventory			
Accounts Receivable			
Buildings, Equipment			
Total Assets			
Liabilities			
Accounts Payable			
Loans			
Net Worth			
Capital Investment			
Earnings Retained			
Total Liabilities & Net Worth			

Item o., Starting Cash, can be the plug-in figure for a new enterprise, that is, the amount of capital required to keep item q., Cumulative Cash Flow, positive. Try doing your early projections with zero Starting Cash in order to determine how deep the worst-case hole is and when it occurs. By approaching the projections in this way, you and your associates force onto paper the nitty-gritty dynamics of the business—what it takes to pay the bills. If you *can't do* a cash flow projection with confidence, you don't understand your business. If you *won't do* a serious cash flow projection that others can critically review, you are kidding yourself about wanting to succeed in big-league entrepreneuring.

From the cash flow projections come the other two major financial indicators you will need: projected operating statements (profit and loss) and projected balance sheets. A skeleton Operating Statement and a skeleton Balance Sheet are included on the previous page for your review.

An Operating Statement summarizes what happened in terms of revenues and expenses during a specified *period of time*. A Balance Sheet is a snapshot of the total financial circumstances of an enterprise, any enterprise from a church to General Motors, at a specified *point in time*. At any such point in time, the sum of the assets must add up to the sum of the liabilities plus the net worth of the enterprise.

There are literally dozens of fine, readable textbooks which include information on how to develop financial statements such as the three described briefly above. Therefore, the details of doing so have not been included in this material on Preparing a Business Plan. Suffice it to say that one or more people on an emerging company's management team, insiders or an outsider such as a growth-company CPA, must be at home with the financial and accounting elements of the business.

The funds flow and financial projections section of the business plan summarizes all of the previous sections in terms of dollars coming and going. At a minimum, this section will include the following projections covering a period of typically two to five years from the time of the business plan:

Projected Cash Flow Projection
Projected Operating Statements
Projected Balance Sheets

With this information, reasoned guesstimates about the future value of the company can be made. In addition, the magnitude and timing of money needs should be roughly evident. Now, questions of the appropriate legal form of the business—sole proprietorship, partnership, corporation, LLC—as well as the nature of any deal with outside investors, can be productively considered.

8.0 OWNERSHIP

The discipline of preparing a business plan helps founders identify the requirements of the enterprise, the In a sense, the business plan is the recipe. Money is usually one ingredient. Money is often tied to ownership.

While all ventures benefit from a business plan, many ventures do not require outside money. For those that do, it is probably obvious that a highly experienced, two-person founding team of an enterprise in need of $2 million in capital faces a somewhat different situation than a young, five-person team in need of only $200,000. That's why general rules for deal making are of limited value. They seldom fit the particular circumstance. The overriding principle is quite simple, however: All the primary participants should feel that any deal finally agreed to is essentially fair. Smart outside investors don't want to put money into a company which has some unhappy team members because they feel they were done wrong. And smart entrepreneurs don't want unhappy investors

who walk away or send in their lawyers the next time money is required or the first time the company bumps into a crisis.

The relative merits of regular corporations versus Subchapter S corporations versus partnerships and LLCs will not be covered here. There are a number of sources of advice on the subject. Your primary guidance should come from your chosen legal and accounting help. Likewise, the merits of common stock versus convertible preferred stock versus various debt instruments are beyond the scope of this commandment. What the ownership section of your business plan should show is your conclusions on these matters plus a recommended financing and ownership scheme covering the time period used in the financial projections.

What should the ownership split be in a startup? Consider a relatively simple case first. Suppose $1 million is needed for a new venture and it has two founders who will personally invest $250,000 each to provide half the total amount needed. In this case, it is clear that the two founders will sell no more than 50 percent of the business to raise the remaining $500,000. If they have a lot of germane experience and have worked long and hard to develop a plan and line up staff, it's likely that they have a strong argument for retaining more than 50 percent of the company for their $500,000 investment. They are putting their money on the line, as well as their careers. If their proposed venture excites prospective investors, it is possible the entrepreneurs in this case can raise the missing $500,000 they need by selling somewhere between 20 and 40 percent of the company...thereby keeping 60 to 80 percent. [Note: In this case, they also *might* be able to borrow part or all of the missing $500,000 and, thereby, further reduce the need for outside equity money.]

Consider a more complex case. Suppose, once again, that $1 million is needed for a new venture. But this time assume there are four prospective founders, two of whom have key technical ideas and expertise and two of whom have broad, relevant business experience. None of the four is able to invest any part of $1 million, but all four will have to leave high-paying jobs to join the new enterprise team where their salaries will be somewhat less. What's fair in this instance? Chances are that the founding team *in total* may end up with 10 to 40 percent of the company *over time* via stock options, staged financing, and other agreed upon mechanisms. This percentage assumes the founders are dealing with professional investors and advisors. It might be possible for the founders to achieve a higher percentage if they are willing to sell part of their enterprise to people who are not professional investors. But this alternative has drawbacks that must be carefully considered by the founders of a potential growth business. For example, if more investment money is needed later, such subsequent rounds of financing (now from professional money sources) may be quite difficult if the company's ownership has already been spread around somewhat indiscriminately.

It is often also a challenge to figure out ways to attract and compensate key, noncash contributors who are needed on the payroll. There are many proven ways to do this. A competent, interested legal firm with rounded new-enterprise experience can assist you.

What if no outside money is needed at all? Suppose two, three, or more people happen onto an opportunity and they can finance the startup themselves. In this third case, any ownership split is pretty much a matter of negotiation between the parties with this proviso: At the earliest possible moment after the business plan is formulated, all the parties involved in the ownership should agree upon and sign a written buy/sell agreement that

spells out precisely what procedures will be followed in the event that one or more of the parties wishes or is forced to disengage from the enterprise. The time to hammer out such an agreement, with the help of an experienced attorney, is before the company gets going. Do it *now*. Tomorrow is frequently too late.

So then, the ownership section of a business plan should cover the entrepreneur's program for financing the business in the early stages and beyond, including these items:

- The legal form of the enterprise.
- The nature of the initial financing envisioned, including pricing and the resulting ownership distribution.
- The nature of projected future rounds of financing, including planned pricing and the resulting ownership distribution.
- The projected returns that any investors will enjoy on the money they have invested in the enterprise.

This last element of information, the projected returns, can often serve handily as the centerpiece of an Overview that you, the writer, prepares and includes at the very front of your business plan.

In summary, this, the Fourth Commandment, stresses the importance of developing a written plan. Such a plan may turn out to be nothing more than an exercise. Done properly, a plan is really a blueprint of the proposed undertaking, done in advance, using the best available information and judgment. The blueprint is a representation, not the business itself. It is a dry run, a simulation. The results of the planning effort may turn out to be negative, i.e., the idea won't work, even on paper. Or, when thoughtfully calculated, the risk/reward ratio may be quite high, too high to attract capital and staff. More likely than not, the very effort required to sweat through the development of a comprehensive

plan will dissuade many potential entrepreneurs. This is as it should be, and by turning back early they may well save themselves from the pain of failing. Business building in these times is not a sure thing. Entrepreneuring isn't for the faint of heart. "Far better it is to dare mighty things . . .," said Teddy Roosevelt. Getting the things you (and others) have in mind down on paper is a useful filtering process before you dare.