The Business Plan: How to Think About It, How to Write It

by JERRY KIRKPATRICK

Introduction

There are two ways to start a business. One is on a shoestring; the other, with financial backing. There is no in-between.

Starting on a shoestring means working part-time out of your garage, basement, or kitchen while continuing to work full time at your regular job. For the shoestring operation, a business plan is advisable, but not essential.

Starting with financial backing means obtaining enough money from investors to sustain you for at least one to two years before your business ever earns a profit. For a well-financed operation, the business plan is the means by which capital is acquired.

Starting a business along the in-between path means withdrawing your savings from the bank, mortgaging your house, quitting your job, and going for broke on the new venture. For one out of three entrepreneurs, however, broke and out of business is the result twelve months later. A business plan will not prevent you from failing, but it might make you think twice before taking that fateful first step—such as mortgaging your house or quitting your job.

Why a Business Plan?

Writing a business plan clarifies and concretizes your thoughts about the new venture. It forces you to think explicitly about issues you might not otherwise have considered and makes real to you what up to the time of writing has only been an idea or dream. The business plan objectifies your dream.

In addition, a business plan can be used to persuade prospective investors to give you money. To obtain financial backing—even from friends or relatives—you must prove to your prospective investors that you will be able to make money for them, by proving that you are competent to run a business and that your idea is sound. A business plan is your sales tool for raising debt and equity capital.

Existing firms also need business plans—as control devices to clarify management's thoughts about what must be done tomorrow, next week, next month, next year, and next decade, and as tools for raising capital, for example, for major expansions of the business.

The Components of a Business Plan

I. Cover Page

A cover page goes first. On it are the name of the business, a brief phrase describing the nature of the business, the name of the founder and/or writer of the plan, and the date the plan was written.

II. Executive Summary

Typical business plans are ten to fifty pages long.

Because prospective investors are busy people, inundated with reading material, their attention and interest must be caught quickly. A one- to two-page summary of the business plan is your most important selling component of the entire plan. It must convince the investor to read on.

The summary also encapsulates your thoughts about the business. The art of summarization is the art of thinking in essentials. The summary, therefore, forces you to separate what is important from what is secondary.

The summary is written *after* the rest of the plan has been completed.

III. Contents

A table of contents, of course, listing the major sections of the plan and their page numbers should be included.

IV. The Business and Its Mission

This section states the essence of the business—in one sentence. A two- to three-paragraph elaboration follows.

The mission statement answers these questions: What is the nature and scope of your business? or What do you foresee it to be? Who are your prospective customers? What are their needs? and How do you propose to satisfy them? How do you differ from the competition? In what direction do you propose to grow and expand?

Mission statements provide focus, direction, and limits to entrepreneurs who, in the early stages of building a business, often become buried in details. Mission statements also guide managers of existing businesses in their evaluation of long-term, strategic options. Finally, mission statements give all employees of the business a calling or vision with which they can identify, thereby imbuing them with a positive attitude toward the company.

The legal form of organization—sole proprietor, partnership, or corporation—and past history of the business, if any, are also stated in this section. Financial statements for the past five years (or however many years the business has been in existence, if fewer than five), including profit and loss, cash flow, and balance sheet statements, should be included either here or discussed here and attached at the end of the plan.

V. Market Review

The market review identifies and evaluates the opportunities and problems your business will face on opening day (or on the day your existing firm's major expansion begins). It describes the past behavior of the market (at least five years' worth of data), projects its future (for one, five, ten, and even twenty-five years), and states where the market stands in the present. The objective of the market review is to state why, given the nature of the competition and the motivation and behavior of your prospective customer, you think there is a niche in the marketplace for your business.

A. The General Environment

This is a review of the broadest context in which your business will operate. It identifies the good and bad trends of the marketplace that will affect your company. These environmental trends, which you cannot control directly and therefore are called "uncontrollable variables," include the economic conditions of the nation or world (e.g., inflation, recession, price controls), legislation (tariffs, deregulation, etc.) demographic trends, technological trends, changes in taste (i.e., fashion trends), and changes in cultural values and customs.

B. Competition

Every company faces competition, especially new ventures.

You must identify precisely who your competition is by answering this question: If prospects do not spend their money on my product, on whom will they spend it? State which industry or specific market segment you will be competing in. How do your competitors differ from you? Why are they not satisfactorily meeting the needs and wants of your prospect?

After you have named the competition, answer these questions: What share of the market does each firm now hold? What are their goals and marketing strategies? What is the size of the total market—in units and in dollars? What trends—in sales, costs, distribution, advertising, operating averages, financial ratios, etc.—have occurred in the past and can be expected to occur in the future? If relevant, this data is usually broken down by geographic regions, market segments, and distribution channels. It is especially important in this section to provide detailed data for the past five years and projections for the next one, five, and, preferably, ten and twenty-five years. The presentation of this data to prospective investors means that you understand your market.

C. Customer/Prospect Motivation and Behavior

Who are your targeted prospects? How and why will they buy your product? How and why do they now buy competitive products? How many prospective customers are there in your market?

Give a demographic and psychographic (e.g., attitudes, personality, lifestyle) profile of your prospect. Summarize and/or attach market research that verifies this profile. State specifically—i.e., as concisely and concretely as possible—which needs and wants your product will satisfy.

What thoughts, images, or emotions—positive and negative—do your prospects exhibit in their consumption behavior that help you to identify their needs and wants?

D. Strengths and Weaknesses of the Business

What advantages—in people, knowledge, and/or assets—does your business have over the competition? What advantages do your competitors have over you?

E. Opportunities and Threats Facing the Business

Based on the above discussion, state the one or two most significant opportunities that give rise to the need for your business. State, also, the one or two major problems or obstacles that threaten to prevent your success.

VI. Marketing Plan

The marketing plan states how your business will take advantage of the opportunities and overcome the problems identified in the market review; the marketing plan describes your product and your strategy for selling it.

A. Objectives and Goals

An objective is a general statement of the end result you intend to achieve with your business or with specific strategies. Begin this section by stating your overall sales and profit objectives. Then state the specific market segments you intend to compete in. Finally, state at least one objective for each of the "4 P's" of marketing strategy—product, price, promotion, place (distribution).[i]

A goal is a quantified objective; it specifies magnitude and a time frame. Thus, if your pricing objective is to maintain a below-market price level for your new product, your goal might be to charge 20% below the competition for the first year of operation, and to increase the price over the next two years only as the press of rising prices calls for it.

The objectives and goals should be specified in detail for the first year of operation and sketched out for the next two to four years.

B. Strategy

Your marketing strategy is the means by which you will achieve your objectives and goals. The objectives state *what* you intend to accomplish; the strategies state *how* you intend to accomplish the objectives.

You should have a strategy statement for each objective described above. If your objective is to price below the market, your pricing strategy might be to use multiple suppliers in order to maintain low-cost materials and to closely monitor the pricing policies of the competition to insure the below-market level.

C. Action Program

Your action program, or tactics, spells out how you will implement the strategies. It states the *who*, *what*, *when*, and *how much?* That is, you assign responsibility to specific managers or employees, you define specific tasks that they will perform, you detail these tasks and responsibilities on a month-by-month basis for the first year and quarterly for the next two to four years of operation, and you indicate the costs of each task that will be undertaken.

VII. Financial Plan

The financial plan shows in detail how and when your venture will turn a profit. It presents profit and loss, cash flow, and balance sheet projections for three to five years. It predicts the breakeven point and lists the sources of capital that you will use to finance the business.

A. Profit and Loss Statement

The profit and loss statement should give your best estimates of sales and expenses over the first three to five years of operation. The first year should present the numbers on a month-by-month basis. The estimates for the remaining years may be presented by quarters.

Your profit and loss statement should include most of the following items:

Sales
- Less Discounts
- Less Materials Used
- Less Direct Labor
- Less Operating Overhead
- Total Cost of Sales

Gross Profit
- Less Selling Expenses
- Less Administrative Expenses

Operating Profit or Loss
- Less Other Expenses (e.g., depreciation)

Profit Before Taxes
- Provision for Income Taxes

Profit After Taxes

The assumptions that your profit and loss projections rest on should be discussed, as well as the risks that could prevent the sales and profit goals from being achieved. An alternative way of presenting profit and loss data that takes into consideration different future scenarios is to list separate profit and loss figures for your best, worst, and expected cases. You will have then covered a range of sales and profit expectations. You should, of course, explain your reasoning behind each set of figures.

B. Cash Flow Statement

This statement is your most important financial projection. The cash flow statement specifies when, and how much, the new business will need cash over the first three to five years. Again, projections should be made on a monthly basis for the first year, quarterly for the remaining years. The cash flow statement tells the entrepreneur how much initial capital he or she will need, as well as working capital, once the business is going.

Most of the following items should be included:

Cash Balance (Opening)

Add Cash Receipts:

Collection of Accounts Receivable

Miscellaneous Receipts

Loan Proceeds

Invested Capital

Total Receipts

Less Disbursements:

Trade Payables

Direct Labor

Operating Overhead

Leased Equipment

Selling Expense

Administrative Expense

Fixed Asset Additions

Income Taxes

Inventory Purchase Payments

Loan Interest

Loan Repayments

Other Payments

Total Disbursements

Cash Balance (Closing)

Cumulative Cash Balance

A discussion of the assumptions and risks in meeting the cash flow goals should follow.

C. Balance Sheet

The balance sheet shows what assets are required to start and operate the business and how those assets are to be financed (i.e., through owner's equity and/or creditors' loans). Balance sheet numbers should be provided for opening day, the end of each quarter for the first year, and the end of each of the first three to five years.

Most of the following items should be included in the balance sheet:

ASSETS	LIABILITIES
<u>Current</u>	<u>Current</u>
Cash	Notes Payable to Banks
Accounts Receivable	Accounts Payable
Inventories	Federal and State Taxes
Prepaid Expenses	Other Current Liabilities
<u>Fixed</u>	<u>Long-Term</u>
Plant and Equipment	Long-Term Notes
Less: Depreciation	Other Long-Term Liabilities
New Plant and Equipment	
Other Fixed Assets	
TOTAL ASSETS	TOTAL LIABILITIES
	OWNER'S EQUITY
	Stock
	Capital Surplus
	Retained Earnings
	TOTAL OWNER'S EQUITY

D. Breakeven Point

The breakeven point is the level of sales at which sales cover all costs; it is the point of zero profit and zero loss. To calculate the breakeven point, use this formula: breakeven quantity = total fixed costs ÷ (price per unit - variable costs per unit), where fixed costs are those costs that do not vary with your level of production, but variable costs do. The breakeven point is often the minimum sales objective of a new business in its first year of operation.

E. Sources of Capital

This section spells out how your business will be financed. You should give the names of all equity investors, amount invested, and shares of ownership received. You should indicate your sources of long-term and short-term debt. Capital sources and amounts should be indicated for opening day and for the end of each of the first three to five years of operation. It is especially important to tie together your capital requirements and your cash flow projections.

If the purpose of your plan is to raise debt and equity capital, then you must distinguish capital that is already committed from that which you are seeking. It is in this section that you state how much money you are requesting from the banker, venture capitalist, relative, or friend for whom the plan has been written. (Assume that you will have to provide about twenty percent of the capital yourself.)

VIII. Operating Plan

The operating plan describes how you will run the business; it can be viewed as the execution of your marketing and financial plans. The operating plan describes your facilities, your method of producing the product, your labor force, and your time schedule for launching the business and implementing the business plan.

A. Geographic Location

Here, you state the location you have selected for your business, the reasons for this location, and the advantages and disadvantages of the location in relation to the market segments you intend to serve and the suppliers you intend to use.

B. Facilities

Your facilities are the plant, office space, equipment, and supplies you will need to start your business. Discuss how much you intend to spend on each item. Discuss how and when you intend to expand facilities over the first three to five years of operation.

C. Operating Strategy

Your operating strategy states how you will produce your product. Whether your business is a manufacturing, wholesaling, retailing, or service firm, you face a variety of "make or buy" decisions. If you "make," describe how you will make whatever it is. If you "buy," discuss from whom, for how much, and why.

Your direct costs—materials and labor—should be presented here, assuming different levels of sales volume. Discuss inventory control, quality control, and adjustments for seasonal irregularities.

D. Management

Discuss here your management team—who they are (by name), their experience and qualifications, their roles in the new venture, and their salaries. Experience and qualifications are what potential investors examine most closely, because the management team is the group of men to whom the investors entrust their money.

Any advisors or consultants to the new business should be mentioned here with their qualifications. This includes legal, banking, and accounting advisors.

E. Time Schedule

This is a considerably detailed listing of all the major events required to launch the business and to achieve its objectives.

Deadlines should be listed and discussed for the following: formation of the company, product development, purchase of materials, hiring of personnel, first sales made, expansion, first profit realized, plus other events that might be critical to the success of the business.

IX. Attachments

This final section of the business plan is where you put the supporting documentation that is required to aid readers in their understanding of your claims. No more, no less.

Conclusion

In essence, a business plan is an outline of how you conceptualize your business.

Bankers and venture capitalists differ over the exact format the plan should take—the one presented in this pamphlet is highly essentialized. There is no magical formula for writing business plans, and there are no shortcuts. Business plans are only as good as the thought and research that go into them. They are only as good as the person who has the idea.

Note the order of this last statement. Venture capitalists judge the person first, then the idea. If they are convinced that you are trustworthy and ambitious—and this must come out in the business plan—they may offer you money but suggest a different or altered idea.

The amount of thought and effort required to write a business plan, not to mention to launch and operate the business, cannot be understated. One successful entrepreneur referred to this as his “proposition 2-1/2,” by which he meant, “No matter how much time and money you plan to put into the business, it will consume twice as much of both and be worth half of what you thought it would or should be.”

Bibliography

To learn "how to" do anything, my rule is: buy three books on the subject, then look for common denominators among them. One book emphasizes certain points, but a second one emphasizes different points. What is common among them is the best guide to what is really important.

Here are three books to give you more detail about how to write a business plan. They are thorough and give plenty of examples, including realistic sample plans.

Mancuso, Joseph R. *How to Write a Winning Business Plan*. This is my favorite book on business plans.

McKeever, Mike, *How to Write a Business Plan*. (The publisher, Nolo Press, specializes in self-help law books, and the company is owned and operated by lawyers who hate lawyers. That makes them my kind of lawyers.)

Siegel, Eric S., Brian R. Ford, and Jay M. Bornstein, *The Ernst & Young Business Plan Guide*.

Appendix

THE PRINCIPLES OF MARKETING[ii]

Marketing is the entrepreneurial function of business that creates need- and want-satisfying products, then delivers them to consumers. The overall goal of marketing is to create customer satisfaction.

Company objective: Strive for high market share through intensive growth and market penetration.

The five components of marketing strategy are:

1. **Market strategy**—A market consists of people who have a need for your product, as well as the purchasing power and authority to buy the product.

Market definition—The most basic principle of marketing is: know your market, or: to know how to market your product, first you must know to whom you are marketing. This means conducting research to define and describe your typical prospect or customer; it means identifying their needs and wants, identifying the competition, and identifying any other variables that might affect your marketing decisions.

Corollary principles: (a) Use the market research information to improve your decisions, (b) Divide your market into segments—because not everyone is a prospect for your product, i.e., not everyone has the same needs and wants. An implication of this is that multiple segments call for multiple products.

Market position (or competitive strategy)—Select positions within market segments that differentiate your products from the competition.

2. **Product strategy**—This refers to the development of new products and the management of existing ones.

The primary principle is "primacy of the product," or "without a good product, you have nothing." "Good," in this context, means meeting the objective, universal needs and optional wants of consumers (e.g., hula-hoops and pet rocks meet the universal need of entertainment, but the optional tastes and preferences of only some consumers).

Develop and market multiple products for multiple segments—develop, primarily, deep and, secondarily, wide product lines.

Use branding for identification and packaging for (customer) convenience.

3. **Pricing strategy**—This means setting prices, determining their flexibility (i.e. fixed pricing vs. a willingness to negotiate), and determining discounts and allowances.

Vary your prices according to product and segment.

Develop price leadership by keeping costs low and quality high, by setting prices high enough to provide a strong return on investment but low enough to prevent the competition from expanding production.

4. **Promotion strategy**—Promotion means communication, the purpose of which is to make a sale. There are four methods of promotion: advertising, personal selling, publicity, and sales promotion (coupons, contests, free samples, etc.).

First, know your product cold.

Then, communicate its unique selling proposition (USP) to your target market. Your USP answers such questions—from the consumer's perspective—as "what's in it for me?" "why should I buy your product?" and "what distinguishes your product from the competition?"

Focus on benefits, but sell the steak (the product's tangible features) as well as the sizzle (the product's intangible benefits).

Match features and benefits to the needs and wants of your segments.

5. **Distribution strategy—**Distribution means physically moving and delivering the product, either through middlemen or directly, to the consumer. It means moving the product to a place or location that is convenient to the consumer.

Treat your middlemen (and suppliers) as intermediate customers (i.e., strive also to meet their needs and wants).

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[i] See the Appendix for a summary of the principles of marketing, or any marketing textbook. See also William A. Cohen, *The Marketing Plan* (available from Amazon.com). Books on business planning, such as those listed in the bibliography of this paper, tend, unfortunately, not to discuss marketing by using the simplified "4 P's" conceptualization.

[ii] Adapted from Fred C. Allvine, *Marketing: Principles and Practices* (New York: Harcourt Brace Jovanovich, Publishers, 1987), viii-xiii.

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Also by JERRY KIRKPATRICK

Em Defesa da Propaganda

In Defense of Advertising