4 Conducting a Feasibility Analysis and Crafting a Winning Business Plan

Learning Objectives

On completion of this chapter, you will be able to:

1. Discuss the steps involved in subjecting a business idea to a feasibility analysis.
2. Explain why every entrepreneur should create a business plan, as well as the benefits of developing a plan.
3. Describe the elements of a solid business plan.
4. Explain the “five Cs of credit” and why they are important to potential lenders and investors reading business plans.
5. Describe the keys to making an effective business plan presentation.
For many entrepreneurs, the easiest part of launching a business is coming up with an idea for a new business concept or approach. As you learned in Chapter 2, entrepreneurs do not lack creativity and are responsible for some of the world’s most important innovations. Business success, however, requires much more than just a great new idea. Once entrepreneurs develop an idea for a business, the next step is to subject it to a feasibility analysis to determine whether they can transform the idea into a viable business. A feasibility analysis is the process of determining whether an entrepreneur’s idea is a viable foundation for creating a successful business. Its purpose is to determine whether a business idea is worth pursuing. If the idea passes the feasibility analysis, the entrepreneur’s next step is to build a solid business plan for capitalizing on the idea. If the idea fails to pass muster, the entrepreneur drops it and moves on to the next opportunity. He or she has not wasted valuable time, money, energy, and other resources creating a full-blown business plan, or worse, launching a business that is destined to fail because it is based on a flawed concept. Although it is impossible for a feasibility study to guarantee an idea’s success, conducting a study reduces the likelihood that entrepreneurs will spend too much of their time pursuing fruitless business ventures.

A feasibility study is not the same as a business plan; both play important, but separate, roles in the start-up process. A feasibility study answers the question, “Should we proceed with this business idea?” Its role is to serve as a filter, screening out ideas that lack the potential for building a successful business, before an entrepreneur commits the necessary resources to building a business plan. A feasibility study primarily is an investigative tool. It is designed to give an entrepreneur a picture of the market, sales, and profit potential of a particular business idea. Will a ski resort located here attract enough customers to be successful? Will customers in this community support a sandwich shop with a retro rock-n-roll theme? Can we build the product at a reasonable cost and sell it at a price customers are willing and able to pay? Does this entrepreneurial team have the ability to implement the idea successfully?

A business plan, on the other hand, is a planning tool for transforming an idea into reality. It builds on the foundation of the feasibility study but provides a more comprehensive analysis than a feasibility study. It functions primarily as a planning tool, taking an idea that has passed the feasibility analysis and describing how to turn it into a successful business. Its primary goals are to guide entrepreneurs as they launch and operate their businesses and to help them acquire the necessary financing to launch.

Feasibility studies are particularly useful when entrepreneurs have generated multiple ideas for business concepts and must winnow their options down to the best choice. They enable entrepreneurs quickly to explore the practicality of each of several potential paths for transforming an idea into a successful business venture. Sometimes the result of a feasibility study is the realization that an idea simply won’t produce a viable business, no matter how it is organized. In other cases, a study shows an entrepreneur that the business idea is a sound one but must be organized in a different fashion to be profitable.

**Conducting a Feasibility Analysis**

A feasibility analysis consists of three interrelated components: an industry and market feasibility analysis, a product or service feasibility analysis, and a financial feasibility analysis (see Figure 4.1).

**Industry and Market Feasibility Analysis**

When evaluating the feasibility of a business idea, entrepreneurs find a basic analysis of the industry and targeted market segments a good starting point. The focus in this phase is twofold: (1) to determine how attractive an industry is overall as a “home” for a new business, and (2) to identify possible niches a small business can occupy profitably.

The first step in assessing industry attractiveness is to paint a picture of the industry with broad strokes, assessing it from a “macro” level. Answering the following questions will help:

- How large is the industry?
- How fast is it growing?
Is the industry as a whole profitable?
Is the industry characterized by high profit margins or razor-thin margins?
How essential are its products or services to customers?
What trends are shaping the industry’s future?
What threats does the industry face?
What opportunities does the industry face?
How crowded is the industry?
How intense is the level of competition in the industry?
Is the industry young, mature, or somewhere in between?

Addressing these questions helps entrepreneurs to determine whether the potential exists for sufficient demand for their products and services.

A useful tool for analyzing an industry’s attractiveness is the five forces model developed by Michael Porter of the Harvard Business School (see Figure 4.2). Five forces interact with one another to determine the setting in which companies compete and hence the attractiveness of the industry: (1) The rivalry among the companies competing in the industry, (2) the bargaining power of suppliers to the industry, (3) the bargaining power of buyers, (4) the threat of new entrants to the industry, and (5) the threat of substitute products or services.

Rivalry Among Companies Competing in the Industry

The strongest of the five forces in most industries is the rivalry that exists among the businesses competing in a particular market. Much like the horses running in the Kentucky Derby, businesses in a market are jockeying for position in an attempt to gain a competitive advantage. When a company
creates an innovation or develops a unique strategy that transforms the market, competing companies must adapt or run the risk of being forced out of business. This force makes markets a dynamic and highly competitive place. Generally, an industry is more attractive when the following conditions hold:

- The number of competitors is large or, at the other extreme, quite small (fewer than five).
- Competitors are not similar in size or capability.
- The industry is growing at a fast pace.
- The opportunity to sell a differentiated product or service is present.

**Bargaining Power of Suppliers to the Industry** The greater the leverage that suppliers of key raw materials or components have, the less attractive is the industry. For instance, because they supply the chips that serve as the “brains” of PCs and because those chips make up a sizeable portion of the cost of a computer, chip makers such as Intel and Advanced Micro Devices (AMD) exert a great deal of power over computer manufacturers such as Dell, Hewlett-Packard, and Gateway. Generally, an industry is more attractive when the following conditions hold:

- Many suppliers sell a commodity product to the companies in it.
- Substitute products are available for the items suppliers provide.
- Companies in the industry find it easy to switch from one supplier to another or to substitute products (i.e., “switching costs” are low).
- The items suppliers provide the industry account for a relatively small portion of the cost of the industry’s finished products.

**Bargaining Power of Buyers** Just as suppliers to an industry can be a source of pressure, buyers also have the potential to can exert significant power over a business, making it less attractive. When the number of customers is small and the cost of switching to competitors’ products is low, buyers’ influence on companies is high. Famous for offering its customers low prices, Wal-Mart, the largest company in the world, is also well known for applying relentless pressure to its 21,000 suppliers for price concessions, which it almost always manages to get. Generally, an industry is more attractive when the following conditions hold:

- Industry customers’ “switching costs” to competitors’ products or to substitutes are relatively high.
- The number of buyers in the industry is large.
- Customers demand products that are differentiated rather than purchase commodity products that they can obtain from any supplier (and subsequently can pit one company against another to drive down price).
- Customers find it difficult to gather information on suppliers’ costs, prices, and product features—something that is becoming much easier for customers in many industries to do by using the World Wide Web.
- The items companies sell to the industry account for a relatively small portion of the cost of their customers’ finished products.

**Threat of New Entrants to the Industry** The larger the pool of potential new entrants to an industry, the greater is the threat to existing companies in it. This is particularly true in industries in which the barriers to entry, such as capital requirements, specialized knowledge, access to distribution channels, and others, are low. Generally, an industry is more attractive to new entrants when the follow conditions hold:

- The advantages of economies of scale are absent. Economies of scale exist when companies in an industry achieve low average costs by producing huge volumes of items (e.g., computer chips).
- Capital requirements to enter the industry are low.
- Cost advantages are not related to company size.
Buyers are not extremely brand-loyal, making it easier for new entrants to the industry to draw customers away from existing businesses.

Governments, through their regulatory and international trade policies, do not restrict new companies from entering the industry.

**Threat of Substitute Products or Services** Substitute products or services can turn an entire industry on its head. For instance, many makers of glass bottles have closed their doors in recent years as their customers—from soft drink bottlers to ketchup makers—have switched to plastic containers, which are lighter, less expensive to ship, and less subject to breakage. Printed newspapers have seen their readership rates decline as new generations of potential readers turn to online sources of news that are constantly updated. Generally, an industry is more attractive when the following conditions hold:

- Quality substitute products are not readily available.
- The prices of substitute products are not significantly lower than those of the industry’s products.
- Buyers’ cost of switching to substitute products is high.

After surveying the power these five forces exert on an industry, entrepreneurs can evaluate the potential for their companies to generate reasonable sales and profits in a particular industry. In other words, they can answer the question, “Is this industry a good home for my business?” Table 4.1 provides a matrix that allows entrepreneurs to assign quantitative scores to the five forces influencing industry attractiveness. Note that the lower the score for an industry, the more attractive it is.

The next step in assessing an industry is to identify potentially attractive niches that exist in it. As you learned in Chapter 2, many small businesses prosper by sticking to niches in a market that are too small to attract the attention of large competitors. Occupying an industry niche enables a business to shield itself to some extent from the power of the five forces. The key questions entrepreneurs address here are, “Can we identify a niche that is large enough to produce a profit? Or can we position our company uniquely in the market to differentiate it from the competition in a meaningful way?”

### TABLE 4.1 Five Forces Matrix

Assign a value to rate the importance of each of the five forces to the industry on a 1 (not important) to 5 (very important) scale. Then assign a value to reflect the threat that each force poses to the industry. Multiply the importance rating in column 2 by the threat rating in column 3 to produce a weighted score. Add the weighted scores in column 3 to get a total weighted score. This score measures the industry’s attractiveness. The matrix is a useful tool for comparing the attractiveness of different industries.

**Minimum Score = 5 (Very attractive)**

**Maximum Score = 125 (Very unattractive)**

<table>
<thead>
<tr>
<th>Force</th>
<th>Importance (1 to 5)</th>
<th>Threat to Industry (1 to 5)</th>
<th>Weighted Score Col 2 x Col 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rivalry among companies competing in the industry</td>
<td>5</td>
<td>5</td>
<td>25</td>
</tr>
<tr>
<td>Bargaining power of suppliers in the industry</td>
<td>2</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>Bargaining power of buyers</td>
<td>2</td>
<td>4</td>
<td>8</td>
</tr>
<tr>
<td>Threat of new entrants to the industry</td>
<td>3</td>
<td>4</td>
<td>12</td>
</tr>
<tr>
<td>Threat of substitute products or services</td>
<td>4</td>
<td>3</td>
<td>12</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td><strong>61</strong></td>
</tr>
</tbody>
</table>

*Scale of importance from 1 = not important to 5 = very important. Scale of threat to the industry from 1 = low, 3 = medium, to 5 = high.*
Entrepreneurs who have designed successful focus or differentiation strategies for their companies can exploit these niches to their advantage.

Questions entrepreneurs should address in this portion of the feasibility analysis include the following:

- Which niche in the market will we occupy?
- How large is this market segment, and how fast is it growing?
- What is the basis for differentiating our product or service from competitors?
- Do we have a superior business model that will be difficult for competitors to reproduce?

In 1984, Michael Dell, founder of Dell Inc., created a superior business model that revolutionized the retail computer industry and toppled the industry leader, IBM, a company that many industry experts thought was invincible when it came to selling personal computers. Dell transformed the industry by designing a business model based on selling customized PCs directly to consumers without using retail outlets. The impact on the company’s fortunes was significant; higher inventory turnover rates, increased customer satisfaction levels, and higher profit margins than the industry average were just some of the benefits Dell experienced. Dell’s model really showed its muscle with the advent of the Web; today, Dell, the industry leader with nearly 35 percent market share in PCs, sells an average of $135 million worth of computers online each day!

One technique for gauging the quality of a company’s business model involves business prototyping, in which entrepreneurs test their business models on a small scale before committing serious resources to launch a business that might not work. Business prototyping recognizes that every business idea is a hypothesis that needs to be tested before an entrepreneur takes it to full scale. If the test supports the hypothesis and its accompanying assumptions, it is time to launch a company. If the prototype flops, the entrepreneur scraps the business idea with only minimal losses and turns to the next idea.

Before they launched Little Earth Productions, Inc., a company that makes distinctive fashion accessories such as belts, handbags, and wallets from recycled bottle caps, license plates, tires, hubcaps, and other items, entrepreneurs Ava DeMarco and Robert Brandegee used business prototyping to test their unique concept. “We had a gut feeling about recycled fashion accessories, and the research we did confirmed our instincts,” says DeMarco. “Before we invested a lot of time and money, we took a look at the market to make certain we were targeting the right buyers and offering products they wanted and could afford.” Their first move was to set up booths displaying their unique products at various arts and crafts festivals in their local community, Pittsburgh.
prototyping to test their concept. The lessons they learned selling their products at arts and crafts festivals allowed them to hone their idea into a successful business.

Pennsylvania. They were able to get face to face with buyers, learn what appealed to them, and find out what they were like—all important steps to building a successful business. They learned, for instance, that their primary customers were people in their teens to mid-30s who appreciated the recycling aspect of the company’s products but were more interested in its distinctive fashion-forward accessories. “It was a good way to watch people use our products,” says DeMarco. “We also got a lot of good feedback on price and comments on how our products worked or didn’t work for them.” Using the information they had gathered from the festivals, DeMarco and Brandegee refined their business concept and rented a booth at a big industry trade show in Miami, where they came away with more than $24,000 worth of orders.3

The World Wide Web makes business prototyping practical, fast, and easy. Entrepreneurs can test their ideas by selling their products on established sites such as eBay or by setting up their own Web sites to gauge customers’ response. Frank Ross, a home-based entrepreneur who dropped out of corporate America, operates three successful online businesses. Before launching them, however, he tested his business concepts on eBay. Ross explains:

If you’re considering selling a product line online as your home-based business, there is really no better place to test a market than eBay. It’s considerable trouble to set up a Web site, and it can be expensive if your product fails. (I’ve made that mistake.) If you want to be sure you have a viable, salable product line prior to going to the trouble and expense of setting up a Web site, try selling on eBay. For the price of a few listings, you will be able to tell very quickly what kind of market you have for your potential Web store, and it may also help you weed out any problems you had not thought of.4

A Circus Strategy

When visitors arrive at the company headquarters of Cirque du Soleil (French for “Circus of the Sun”) in Montreal, Quebec, the 27-foot-long clown shoe is the first hint that the company it houses is quite unique. Indeed, Cirque du Soleil is one of the most successful entertainment companies in the world, and its success is due to the differentiation strategy that the company executes with the same precision that its world-class acrobats demonstrate in their performances. All 15 of the productions the company has created since its founding in 1984 have been huge successes, a particularly impressive record when considering the fact that 9 of 10 Broadway shows fail to earn back the money originally invested in them. Five Cirque shows tour the globe accompanied by their own custom-designed 2,500-seat tents; four others play in permanent locations in Las Vegas and Orlando. Even though ticket prices range from $45 to $150, Cirque manages to sell 97 percent of available seats for its shows. Although it uses the word “circus” in its name, Cirque is a far cry
from the traditional traveling circus with its ringmaster, clowns, tightrope walkers, and daredevils. Cirque shows feature the same types of performers as traditional circuses, but it combines them in innovative, off-the-wall acts with New Age music, surreal costumes, and dazzling staging to create some of the most memorable and entertaining shows on the planet. For example, in its show called O, trapeze artists swing high above the stage before diving into a huge, 25-foot-deep on-stage lake that disappears in seconds with the help of a hydraulically powered pump designed by the company's team of talented engineers. Cirque du Soleil's strategy incorporates five key components that enable it to hold a unique position in the entertainment market:

1. **Meticulous brand management.** Cirque is a hotbed of creativity, and managers guard the brand carefully. Shows have a long gestation period (about three years) to ensure quality and distinctiveness. "Each show is a new member of the family, and we never want twins," says Daniel Gauthier, co-founder of Cirque.

2. **Acquisition of world-class talent.** At the heart of every show are the performers, and Cirque constantly patrols the world in search of the best. The company has 12 full-time talent scouts who travel the globe searching out performers whom they add to the company's database (the largest of its kind in the world) of 20,000 potential recruits. The scouts have recruited performers from such far-flung places as the Olympic games, the Moscow Circus school, a Mongolian elementary school, and the Imperial Orgy erotic arts festival in New York City.

3. **Stringent cost control.** Top managers meet with creative directors to set a budget and an opening date for each new show and then step back and let the directors work their creative magic. The directors can spend the budget—typically $10 to $25 million—in any way they choose, and company president Daniel Lamarre says that no director has ever come back to ask for more money. "Cirque allows you to approach shows with the artistic priority first," explains Franco Dragone, who led the creative teams for six of Cirque's nine current productions.

4. **Investment in research and development (R&D).** To make certain that its shows are different from those of other entertainment companies and stimulating to its target audience (which is very upscale, college-educated, and heavily populated by women), Cirque invests heavily in R&D. As a percentage of sales, the company spends on R&D twice what the average U.S. corporation spends, and it shows on stage—from the unusual props performers use and waterproof makeup invented by Cirque cosmetologists to the evaporating indoor lake and an elaborate on-stage blizzard. The technology keeps audiences mesmerized, wondering what is coming next.

5. **Concerted efforts in opportunity recognition and strategic planning.** Cirque managers intentionally have kept the company growing at a controlled pace. Building on the company's ability to transform itself in each of its unique shows, managers are considering expanding Cirque's circle of influence. "We define ourselves as a creative content provider," explains Lamarre. In the future, managers are planning to take Cirque's creative approach into new industries such as television, hotels, restaurants, and nightclubs. "Whether you are an innkeeper or a restaurateur, you are entertaining on some level," says Lyn Heward, president of the creative content division (and a former competitive gymnastics coach). Ideas being batted around for a Cirque resort include a Las Vegas resort that would feature New Age music, brightly colored furniture, and theatrical lighting throughout the building. Lamarre envisions jugglers serving as waiters. "We want to challenge our creative people to work in new mediums," he says.

Questions

1. How has Cirque du Soleil redefined the industry in which it competes with its differentiation strategy? What benefits does the company reap from having done so?

2. Use the Web to learn more about Cirque du Soleil's unique approach to the entertainment industry. Select one of the projects the company is considering as part of its strategy for the future (television show, hotel, restaurants, and nightclubs). Work with a team of your classmates to brainstorm ideas for applying Cirque's unique approach to entertainment to the project you selected.

3. How would you define the company's core competencies? Given these core competencies, can you spot other opportunities Cirque might be able to exploit?

4. What threats does the company's strategies pose?

Product or Service Feasibility Analysis

Once entrepreneurs discover that sufficient market potential for their product or service idea actually exists, they sometimes rush in with their exuberant enthusiasm ready to launch a business without actually considering whether they can actually produce the product or provide the service at a reasonable cost. A **product or service feasibility analysis** determines the degree to which a product or service idea appeals to potential customers and identifies the resources necessary to produce the product or provide the service. This portion of the feasibility analysis addresses two questions:

- Are customers willing to purchase our goods and services?
- Can we provide the product or service to customers at a profit?

To answer these questions, entrepreneurs need feedback from potential customers. Getting that feedback might involve engaging in primary research such as customer surveys and focus groups, gathering secondary customer research, building prototypes, and conducting in-home trials.

**Conducting primary research** involves collecting data first-hand and analyzing it; **secondary research** involves gathering data that have already been compiled and are available, often at a very reasonable cost or sometimes even free. In both types of research, gathering both quantitative and qualitative information is important to drawing accurate conclusions about a product’s or service’s market potential. Primary research techniques include the following:

**Customer surveys and questionnaires.** Keep them short. Word your questions carefully so that you do not bias the results, and use a simple ranking system (e.g., a 1-to-5 scale, with 1 representing “definitely would not buy” and 5 representing “definitely would buy”). Test your survey for problems on a small number of people before putting it to use. Web surveys are inexpensive, easy to conduct, and provide feedback fast. Monster.com, the online job search company, recently conducted an online survey of 30,000 customers and integrated the results from the survey into every aspect of the company’s operation. “The survey results impact policy, process, product development and marketing efforts,” says Chip Henry, Monster.com’s, vice president, voice of the customer (note the unique job title). “There’s nothing in the company that isn’t touched as a result of the surveys.”

**Focus groups.** A **focus group** involves enlisting a small number of potential customers (usually 8 to 12) to give feedback on specific issues about a product or service (or the business idea itself). Listen carefully for what focus group members like and don’t like about your product or service as they tell you what is on their minds. The founders of one small snack food company that produced apple chips conducted several focus groups to gauge customers’ acceptance of the product and to guide many key business decisions, ranging from the product’s name to its packaging. Once again, consider creating virtual focus groups on the Web; one small bicycle retailer conducts 10 online focus groups each year at virtually no cost and gains valuable marketing information from them. Feedback from online customers is fast, convenient, and real-time.

Secondary research, which is usually less expensive to collect than primary data, includes the following sources:

**Trade associations and business directories.** To locate a trade association, use *Business Information Sources* (University of California Press) or the *Encyclopedia of Associations* (Gale Research). To find suppliers, use *The Thomas Register of American Manufacturers* (Thomas Publishing Company) or *Standard and Poor’s Register of Corporations, Executives, and Industries* (Standard and Poor Corporation). The *American Wholesalers and Distributors Directory* includes details on more than 18,000 wholesalers and distributors.

**Direct mail lists.** You can buy mailing lists for practically any type of business. *The Standard Rates and Data Service (SRDS) Directory of Mailing Lists* (Standard Rates and Data) is a good place to start looking.
Demographic data. To learn more about the demographic characteristics of customers in general, use The Statistical Abstract of the United States (Government Printing Office). Profiles of more specific regions are available in The State and Metropolitan Data Book (Government Printing Office). The Sourcebook of Zip Code Demographics (CACI, Inc.) provides detailed breakdowns of the population in every zip code in the country. Sales and Marketing Management's Survey of Buying Power (Bill Communications) has statistics on consumer, retail, and industrial buying. Demographics USA provides users with one of the most extensive collections of demographic and marketing data available. It contains more than 1,700 pages of useful reports, which range from business characteristics and retail sales by merchandise line to buying power indices and detailed demographics by county and by zip code.

Census data. The Bureau of the Census publishes a wide variety of reports that summarize the wealth of data found in its census database, which is available at most libraries and at the Census Bureau's Web site (http://www.census.gov).

Forecasts. The U.S. Global Outlook traces the growth of 200 industries and gives a five-year forecast for each one. Many government agencies, including the Department of Commerce, offer forecasts on everything from interest rates to the number of housing starts. A government librarian can help you to find what you need.

Market research. Someone may already have compiled the market research you need. The FINdex Worldwide Directory of Market Research Reports, Studies, and Surveys (Cambridge Information Group) lists more than 10,600 studies available for purchase. Other directories of business research include Simmons Study of Media and Markets (Simmons Market Research Bureau Inc.) and the A.C. Neilsen Retail Index (A.C. Neilsen Company).

Articles. Magazine and journal articles pertinent to your business are a great source of information. Use the Reader's Guide to Periodical Literature, the Business Periodicals Index (similar to the Reader's Guide but focuses on business periodicals), and Ulrich's Guide to International Periodicals to locate the ones you need.

Local data. Your state department of commerce and your local chamber of commerce will very likely have useful data on the local market of interest to you. Call to find out what is available.

World Wide Web. Most entrepreneurs are astounded at the marketing information that is available on the World Wide Web (WWW). Using one of the search engines, you can gain access to a world of information—literally!

Prototypes One of the most effective ways to gauge the viability of a product is to build a prototype of it. A prototype is an original, functional model of a new product that entrepreneurs can put into the hands of potential customers so that they can see it, test it, and use it. Prototypes usually point out potential problems in a product's design, giving inventors the opportunity to fix them even before they put the prototype into customers' hands. The feedback customers give entrepreneurs based on prototypes often leads to design improvements and new features, some of which the entrepreneurs might never have discovered on their own. Makers of computer software frequently put prototypes of new products into customers' hands as they develop new products or improve existing ones. Known as beta tests, these trials result in an iterative design process in which software designers collect feedback from users and then incorporate their ideas into the product for the next round of tests.

Entrepreneur Shawn Donegan teamed up with inventor Mike Puczowski to launch Trac Tool Inc., a Cleveland, Ohio–based business that markets Speed Rollers, a paint application system aimed at professional paint contractors. Puczowski's invention features an airless paint pump that feeds paint onto one of two rollers, eliminating the need to dip the rollers into a paint tray and making the system four to five times faster than using traditional rollers. Donegan and Puczowski built several models of the system before they had a prototype that worked. Early prototypes pointed out several problems the
Existing companies can benefit from creating prototypes as well. As their business grew, Ava DeMarco and Robert Brandegee, founders of Little Earth Productions, changed their approach to developing new products. “When we first started out, we designed new products two weeks before a trade show and hoped people would buy them,” says DeMarco. Today, the company creates a small number of prototypes, places them in half a dozen or so retail stores, and tests customers’ responses to them. “The feedback lets us know if we’re on the right track with a new product before we invest time and money,” explains DeMarco.

**In-Home Trials**

One technique that reveals some of the most insightful information into how customers actually use a product or service is also the most challenging to coordinate: in-home trials. An in-home trial involves sending researchers into customers’ homes to observe them as they use the company’s product or service.

**Intuit**

Intuit, the software company that produces popular programs such as Quicken, QuickBooks, and TurboTax, was one of the first companies to adopt in-home trials as part of its product development process in 1989. In the company’s follow-me-home program, software engineers hang around a retail store, waiting for customers to buy an Intuit product. They then ask to go into customers’ homes, where they watch how customers install and use the software and listen to their suggestions in a natural setting. Intuit has adapted the program to its call centers, where customers call with questions about Intuit software. Software managers and product engineers periodically sit at call center employees’ desks, looking for ways to improve the employees’ ability to serve customers more effectively. The company also combs through blogs and Intuit online communities, looking for comments and feedback about its software products. The process works; the latest version of Quicken included 121 customer-recommended improvements.

**Financial Feasibility Analysis**

The final component of a feasibility analysis involves assessing the financial feasibility of a proposed business venture. At this stage of the process, a broad financial analysis is sufficient. If the business concept passes the overall feasibility analysis, an entrepreneur should conduct a more thorough financial analysis when creating a full-blown business plan. The major elements to be included in a financial feasibility analysis include the initial capital requirement, estimated earnings, and the resulting return on investment.

**Capital Requirements**

Just as a Boy Scout needs fuel to start a fire, an entrepreneur needs capital to start a business. Some businesses require large amounts of capital, but others do not. Typically, service businesses require less capital to launch than manufacturing or retail businesses. Start-up companies often need capital to purchase equipment, buildings, technology, and other tangible assets as well as to hire and train employees, promote their products and services, and establish a presence in the market. A good feasibility analysis will provide an estimate of the amount of start-up capital an entrepreneur will need to get the business up and running. For instance, Shawn Donegan and Mike Puczkowski needed $150,000 to launch Trac Tool Inc. and bring the Speed Rollers paint system to market. They spent most of that start-up capital to develop and test the prototype and to introduce the product at the Painting and Decorating Contractors of America trade show.

You will learn more about finding sources of business funding, both debt and equity, in Chapter 13, “Sources of Financing: Debt and Equity.”
Estimated Earnings In addition to producing an estimate of the start-up company’s capital requirements, an entrepreneur also should forecast the earning potential of the proposed business. Industry trade associations and publications such as the RMA Annual Statement Studies offer guidelines on preparing sales and earnings estimates. From these, entrepreneurs can estimate the financial results they and their investors can expect to see from the business venture.

Return on Investment The final aspect of the financial feasibility analysis combines the estimated earnings and the capital requirements to determine the rate of return the venture is expected to produce. One simple measure is the rate of return on the capital invested, which is calculated by dividing the estimated earnings the business yields by the amount of capital invested in the business. Although financial estimates at the feasibility analysis stage typically are rough, they are an important part of the entrepreneur’s ultimate “go/no go” decision about the business ventures. A venture must produce an attractive rate of return relative to the level of risk it requires. This risk–return tradeoff means that the higher the level of risk a prospective business involves, the higher the rate of return it must provide to the entrepreneur and investors. Why should an entrepreneur take on all of the risks of starting and running a business that produces a mere three or four percent rate of return when he or she could earn that much in a risk-free investment at a bank or other financial institution? You will learn more about developing detailed financial forecasts for a business start-up in Chapter 10, “Creating a Successful Financial Plan.”

Wise entrepreneurs take the time to subject their ideas to a feasibility analysis like the one described here, whatever outcome it produces. If the study suggests that transforming the idea into a viable business is not feasible, the entrepreneur can move on to the next idea, confident that he or she has not wasted valuable resources launching a business destined to fail. If the analysis shows that the idea has real potential as a profitable business, the entrepreneur can pursue it, using the information gathered during the feasibility analysis as the foundation for building a sound business plan. We now turn our attention to that process.

How a Ruined Shirt Launched a Successful Venture

A simple trip to the dry cleaners changed Robert Byerley’s career path. When the Dallas businessman picked up his clothes, he discovered that the cleaner had ruined one of his $100 dress shirts. He would have been satisfied if the owner of the cleaner had offered to replace his shirt, but he did not. He didn’t even apologize to Byerley, and that’s when Byerley decided to do something about it.

Although the Dallas market was crowded with dry cleaning establishments, Byerley left his corporate job to launch Bibbentuckers, a dry cleaning operation that offers Dallas residents better quality and better service at higher prices than other dry cleaning establishments. He suspected that a segment of the market would be willing to pay premium prices for a cleaner that offered convenient locations, superior quality and service, and extra amenities. Byerley didn’t rely on his instincts alone, however. Before starting Bibbentuckers, Byerley did plenty of research and put together a business plan to guide his entrepreneurial venture.

He started with the vision he had for his business. One night when he couldn’t sleep, Byerley began listing the characteristics he wanted his dry cleaners to exhibit. Based on his negative experience with his former dry cleaner, Byerley listed “standing behind our work” first. He listed nine other items, including a drive-up service with curbside delivery, a computerized system that would track clothes through the entire process and would use bar code scanners to read customers’ cleaning preferences, and a cleaning process that used the most current, environmentally friendly equipment and materials.
The one item that was not on his list: low prices. “The things I wanted in a perfect dry cleaner were incompatible with a discount operation,” he explains.

Byerley’s next step was to research the industry and the market potential for his venture. He spent a solid week in the library, where he learned all about the dry cleaning industry, a $16 billion-a-year business dominated by small independent operators who competed primarily on the basis of price. He also discovered that dry cleaning establishments accounted for a large number of customer complaints with the Better Business Bureau. The number one complaint? “Cleaners didn’t stand behind what they did,” says Byerley with a smile. He also learned about legislation that was about to take effect that would change the way cleaners handled their cleaning solvents.

As he assembled his plan, Byerley realized he could use his environmentally friendly approach to cleaning as a marketing tool, something that very few operators were doing. He researched the existing competition in Dallas and discovered that several dry cleaners were taking a premium approach to the market. Realizing that he had to differentiate his business from his competitors, Byerley gave his outlets a unique and appealing design. The free-standing stores’ professionally appointed décor included attractive awnings and drive-through lanes as well as television screens and free refreshments. “I wanted a place that people would feel comfortable leaving their best clothes, a place that paired five-star service with an establishment that didn’t look like a dry cleaner,” he says.

One key question to be answered, of course, was “Would customers be willing to pay for quality, service, and convenience?” To find out, Byerley hired a marketing firm and conducted focus groups of potential customers. “I paired five-star service with an establishment that didn’t look like a dry cleaner,” he says.

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Why Develop a Business Plan?

Any entrepreneur who is in business or is about to launch a business needs a well-conceived and factually based business plan to increase the likelihood of success. For decades, research has proven that companies that engage in business planning outperform those that do not. Unfortunately, studies also show that small companies are especially lack-advisical in their approach to developing business plans. Many entrepreneurs never take the time to develop plans for their businesses; unfortunately, the implications of the lack of planning are all too evident in the high failure rates that small companies experience.

A business plan is a written summary of an entrepreneur’s proposed business venture, its operational and financial details, its marketing opportunities and strategy, and its managers’ skills and abilities. There is no substitute for a well-prepared business plan, and there are no shortcuts to creating one. The plan serves as an entrepreneur’s road map on the journey toward building a successful business. It describes the direction the company is
Taking, what its goals are, where it wants to be, and how it’s going to get there. The plan is written proof that an entrepreneur has performed the necessary research, has studied the business opportunity adequately, and is prepared to capitalize on it with a sound business model. In short, a business plan is an entrepreneur’s best insurance against launching a business destined to fail or mismanaging a potentially successful company.

A business plan serves three essential functions. First and most important, it guides an entrepreneur by charting the company’s future course of action and devising a strategy for success. The plan provides a battery of tools—a mission statement, goals, objectives, market analysis, budgets, financial forecasts, target markets, and strategies—to help entrepreneurs lead a company successfully. It gives managers and employees a sense of direction, but only if everyone is involved in creating, updating, or altering it. As more team members become committed to making the plan work, the plan takes on special meaning. It gives everyone targets to shoot for, and it provides a yardstick for measuring actual performance against those targets, especially in the crucial and chaotic start-up phase. Creating a plan also forces entrepreneurs to subject their ideas to the test of reality. Can this business idea actually produce a profit?

The second function of the business plan is to attract lenders and investors. Too often small business owners approach potential lenders and investors without having prepared to sell themselves and their business concept. Simply scribbling a few rough figures on a notepad to support a loan application is not enough. Applying for loans or attempting to attract investors without a solid business plan rarely attracts needed capital. Rather, the best way to secure the necessary capital is to prepare a sound business plan, which enables an entrepreneur to communicate to potential lenders and investors the potential the business opportunity offers. Entrepreneurs must pay attention to details because they are germane to their sales presentations to potential lenders and investors. The quality of the firm’s business plan weighs heavily in the decision to lend or invest funds. It is also potential lenders’ and investors’ first impression of the company and its managers. Therefore, the finished product should be highly polished and professional in both form and content.

A business plan must prove to potential lenders and investors that a venture will be able to repay loans and produce an attractive rate of return. Entrepreneur and author Neal Stephenson, who started several high-tech companies before focusing on a writing career, explains his experience writing a business plan:

As I was trying to write my plan, something came into focus for me that should have been obvious from the very beginning. I was proposing to borrow a lot of money from strangers and gamble it on doing something. If it didn’t work, these people would lose their money, which is a very sobering prospect. It really shakes you up and makes you think very hard about what it is you are doing . . . . We’re using other people’s real money, and those people could get hurt.\textsuperscript{10}

Building a plan forces a potential entrepreneur to look at his or her business idea in the harsh light of reality. It also requires the entrepreneur to assess the venture’s chances of success more objectively. A well-assembled plan helps prove to outsiders that a business idea can be successful. To get external financing, an entrepreneur’s plan must pass three tests with potential lenders and investors: (1) the reality test, (2) the competitive test, and (3) the value test. The first two tests have both an external and an internal component:

**Reality test.** The external component of the reality test revolves around proving that a market for the product or service really does exist. It focuses on industry attractiveness, market niches, potential customers, market size, degree of competition, and similar factors. Entrepreneurs who pass this part of the reality test prove in the marketing portion of their business plan that there is strong demand for their business idea. The internal component of the reality test focuses on the product or service itself. Can the company really build it for the cost estimates in the business plan? Is it truly different from what competitors are already selling? Does it offer customers something of value?
Competitive test. The external part of the competitive test evaluates the company’s relative position to its key competitors. How do the company’s strengths and weaknesses match up with those of the competition? Do these reactions threaten the new company’s success and survival?

The internal competitive test focuses on management’s ability to create a company that will gain an edge over existing rivals. To pass this part of the competitive test, a plan must prove the quality, skill, and experience of the venture’s management team. What other resources does the company have that can give it a competitive edge in the market?

Value test. To convince lenders and investors to put their money into the venture, a business plan must prove to them that it offers a high probability of repayment or an attractive rate of return. Entrepreneurs usually see their businesses as good investments because they consider the intangibles of owning a business—gaining control over their own destinies, freedom to do what they enjoy, and other factors; lenders and investors, however, look at a venture in colder terms: dollar-for-dollar returns. A plan must convince lenders and investors that they will earn an attractive return on their money. The same business basics that investors have employed for decades to evaluate the financial potential of a new venture are still valid today, although during the dot-com craze in the late 1990s, many entrepreneurs and investors lost site of the importance of practical, profitable business models. The collapse of many of those dot-com companies at the beginning of the twenty-first century proved that unrealistic “smoke and mirror” assumptions are no substitute for sound business basics. “Those businesses had full tech staffs and fat marketing budgets,” says one business writer, “but a lot of them went belly up because their business plans were no better than the Titanic’s plans for dealing with icebergs.”

Today what matters most are realistic financial projections based on research and reasonable assumptions. A new venture must have both a long-term strategic vision and a practical focus on operations. In their business plans, entrepreneurs must be able to communicate clearly an understanding of the following issues:

- Cost of raw materials and supplies
- Unit labor costs
- Market-determined selling prices and gross profit margins
- Break-even point for their businesses

Sometimes the greatest service a business plan provides an entrepreneur is the realization that “it just won’t work.” The time to find out a potential business idea won’t succeed is in the planning stages before an entrepreneur commits significant resources to a venture. In other cases it reveals important problems to overcome before launching a company.

The real value in preparing a business plan is not so much in the plan itself as it is in the process an entrepreneur goes through to create the plan. Although the finished product is useful, the process of building a plan requires an entrepreneur to subject his or her idea to an objective, critical evaluation. What the entrepreneur learns about his or her company, its target market, its financial requirements, and other factors can be essential to making the venture a success. This process allows the entrepreneur to replace “I think’s” with more “I know’s” and to make mistakes on paper, which is much cheaper than making them in reality. Simply put, building a business plan reduces the risk and uncertainty in launching a company by teaching the entrepreneur to do it the right way!

Third, a business plan is a reflection of its creator. It should demonstrate that the entrepreneur has thought seriously about the venture and what will make it succeed. Preparing a solid plan demonstrates that the entrepreneur has taken the time to commit the idea to paper. Building a plan also forces the entrepreneur to consider both the positive and the negative aspects of the business. A detailed and thoughtfully developed business plan makes a positive first impression on those who read it. In most cases, potential lenders and investors read a business plan before they ever meet with the entrepreneur.
behind it. Sophisticated investors will not take the time to meet with an entrepreneur whose business plan fails to reflect a serious investment of time and energy. They know that an entrepreneur who lacks this discipline to develop a good business plan likely lacks the discipline to run a business.

The business plan should reflect the fire and passion an entrepreneur has for the venture. For this reason an entrepreneur cannot allow others to prepare the business plan for him or her because outsiders cannot understand the business nor envision the proposed company as well as the entrepreneur can. The entrepreneur is the driving force behind the business idea and is the one who can best convey the vision and the enthusiasm he or she has for transforming that idea into a successful business. In addition, because the entrepreneur will make the presentation to potential lenders and investors, he or she must understand every detail of the business plan. Otherwise, an entrepreneur cannot present it convincingly, and in most cases the financial institution or investor will reject it. Investors want to feel confident that an entrepreneur has realistically evaluated the risk involved in the new venture and has a strategy for addressing it. Furthermore, as you can expect, they also want to see proof that a business will be profitable and produce a reasonable return on their investment.

Perhaps the best way to understand the need for a business plan is to recognize the validity of the “two-thirds rule,” which says that only two-thirds of the entrepreneurs with a sound and viable new business venture will find financial backing. Those who do find financial backing will only get two-thirds of what they initially requested, and it will take them two-thirds longer to get the financing than they anticipated. The most effective strategy for avoiding the two-thirds rule is to build a business plan!

The Elements of a Business Plan

Smart entrepreneurs recognize that every business plan is unique and must be tailor-made. They avoid the off-the-shelf, “cookie-cutter” approach that produces look-alike plans. The elements of a business plan may be standard, but the way entrepreneurs tell their stories should be unique and reflect their enthusiasm for the new venture. If this is a first attempt at writing a business plan, it may be very helpful to seek the advice of individuals with experience in this process. Accountants, business professors, attorneys, and consultants with Small Business Development Centers can be excellent sources of advice in creating and refining a plan. (For a list of Small Business Development Center locations, see the Small Business Administration’s Web SBDC Web page at http://www.sba.gov/SBDC/.) Entrepreneurs also can use business planning software available from several companies to create their plans. Some of the most popular programs include Business Plan Pro (Palo Alto Software), BizPlan Builder (Jian Tools), PlanMaker (Power Solutions for Business), and Plan Write (Business Resources Software). These planning packages help entrepreneurs to organize the material they have researched and gathered, and they provide helpful tips on plan writing and templates for creating financial statements. These planning packages produce professional-looking business plans, but entrepreneurs who use them face one drawback: the plans they produce often look the same, as if they came from the same mold. That can be a turn-off for professional investors, who see hundreds of business plans each year.

Initially, the prospect of writing a business plan may appear to be overwhelming. Many entrepreneurs would rather launch their companies and “see what happens” than invest the necessary time and energy defining and researching their target markets, defining their strategies, and mapping out their finances. After all, building a plan is hard work! However, it is hard work that pays many dividends, not all of which are immediately apparent. Entrepreneurs who invest their time and energy in building plans are better prepared to face the hostile environment in which their companies will compete than those who do not. Earlier, we said that a business plan is like a road map that guides an entrepreneur on the journey to building a successful business. If you were making a journey to a particular destination through unfamiliar, harsh, and dangerous territory, would you rather ride with someone equipped with a road map and a trip itinerary or with someone who

**Learning Objectives**

3. Describe the elements of a solid business plan.
didn’t believe in road maps or in planning trips, destinations, and layovers? Although building a business plan does not guarantee success, it does raise an entrepreneur’s chances of succeeding in business.

A business plan typically ranges from 25 to 40 pages in length. Shorter plans usually are too sketchy to be of any value, and those much longer than this run the risk of never getting used or read! This section explains the most common elements of a business plan. However, entrepreneurs must recognize that, like every business venture, every business plan is unique. An entrepreneur should view the following elements as a starting point for building a plan and should modify them as needed to better tell the story of his or her new venture.

**Title Page and Table of Contents**

A business plan is a professional document and should contain a title page with the company’s name, logo, and address as well as the names and contact information of the company founders. Many entrepreneurs also include on the title page the copy number of the plan and the date on which it was issued.

Business plan readers appreciate a table of contents that includes page numbers so that they can locate the particular sections of the plan in which they are most interested.

**Executive Summary**

To summarize the presentation to each potential financial institution or investors, the entrepreneur should write an executive summary. It should be concise—a maximum of two pages—and should summarize all of the relevant points of the business venture. The executive summary is a synopsis of the entire plan, capturing its essence in a capsulized form. It should briefly describe the following:

- The company’s business model and the basis for its competitive edge.
- The company’s target market(s) and the benefits its products or services will provide customers.
- The qualifications of the founders and key employees.
- The key financial highlights (e.g., sales and earnings projections, capital required, rates of return on the investment, and when any loans will be repaid).

The executive summary is a written version of what is known as “the elevator pitch.” Imagine yourself on an elevator with a potential lender or investor. Only the two of you are on the elevator, and you have that person’s undivided attention for the duration of the ride, but the building is not very tall! To convince the investor that your business is a great investment, you must boil your message down to its essence—key points that you can communicate in just a matter of one or two minutes.

The executive summary must capture the reader’s attention. If it misses the mark, the chances of the remainder of the plan being read are minimal. A well-developed, coherent summary introducing the financial proposal establishes a favorable first impression of the entrepreneur and the business and can go a long way toward obtaining financing. Although the executive summary is the first part of the business plan, it should be the last section written.

**Vision and Mission Statement**

As you learned in Chapter 3, a mission statement expresses in words an entrepreneur’s vision for what his or her company is and what it is to become. It is the broadest expression of a company’s purpose and defines the direction in which it will move. It anchors a company in reality and serves as the thesis statement for the entire business plan. Every good plan captures an entrepreneur’s passion and vision for the business, and the mission statement is the ideal place to express them.

**Company History**

The owner of an existing small business who is creating a business plan should prepare a brief history of the operation, highlighting the significant financial and operational events in
the company’s life. This section should describe when and why the company was formed, how it has evolved over time, and what the owner envisions for the future. It should highlight the successful accomplishment of past objectives such as developing prototypes, earning patents, achieving market-share targets, or securing long-term customer contracts. This section also should describe the company’s current image in the marketplace.

**Business and Industry Profile**

To acquaint lenders and investors with the industry in which a company competes, an entrepreneur should describe it in the business plan. This section should provide the reader with an overview of the industry or market segment in which the new venture will operate. Industry data such as market size, growth trends, and the relative economic and competitive strength of the major firms in the industry all set the stage for a better understanding of the viability of the new product or service. Strategic issues such as ease of market entry and exit, the ability to achieve economies of scale or scope, and the existence of cyclical or seasonal economic trends further help readers to evaluate the new venture. This part of the plan also should describe significant industry trends and key success factors as well as an overall outlook for its future. Information about the evolution of the industry helps the reader to comprehend its competitive dynamics. The *U.S. Industrial Outlook Handbook* is an excellent reference that profiles a variety of industries and offers projections for future trends in them. Another useful resource of industry and economic information is the *Summary of Commentary on Current Economic Conditions*, more commonly known as the Beige Book. Published eight times a year by the Federal Reserve, the Beige Book provides detailed statistics and trends in key business sectors and in the overall economy. It offers valuable information on topics ranging from tourism and housing starts to consumer spending and wage rates. Entrepreneurs can find this wealth of information at their fingertips on the Web at [http://www.federalreserve.gov/FOMC/BeigeBook/2005/](http://www.federalreserve.gov/FOMC/BeigeBook/2005/).

This portion of the plan also should describe the existing and anticipated profitability of the industry. Any significant entry or exit of firms or consolidations and mergers should be discussed in terms of their impact on the competitive behavior of the market. The entrepreneur also should mention any events that have significantly affected the industry in the last 10 years.

This section should contain a statement of the company’s general business goals and then work down to a narrower definition of its immediate objectives. Together they should spell out what the business plans to accomplish and how, when, and who will do it. **Goals** are broad, long-range statements of what a company plans to achieve in the future that guide its overall direction. In other words, they address the question, “What do I want my company to look like in three to five years?”

**Objectives**, on the other hand, are short-term, specific performance targets that are attainable, measurable, and controllable. Every objective should reflect some general business goal and should include a technique for measuring progress toward its accomplishment. To be meaningful, an objective must have a time frame for achievement. Both goals and objectives should relate to the company’s basic mission (see Figure 4.3).

**Business Strategy**

Another important part of a business plan is the owner’s view of the strategy needed to meet—and beat—the competition. In the previous section, the entrepreneur defined *where* to take the business by establishing goals and objectives. This section addresses the question of *how* to get there—business strategy. Here an entrepreneur must explain how he or she plans to gain a competitive edge in the market and what sets the business apart from the competition. The entrepreneur should comment on how he or she plans to achieve business goals and objectives in the face of competition and government regulation and should identify the image that the business will try to project. An important theme in this section is what makes the company unique in the eyes of its customers. One of the quickest routes to business failure is trying to sell “me-too” products or services that offer customers nothing new, better, bigger, faster, more convenient, or different from existing products or services.
While renovating their top-floor apartment in Stockholm, Sweden, civil engineers Håkan and Annika Olsson came up with a unique idea for creating high-quality modular penthouses that could be manufactured in factories and installed atop existing flat-roof buildings. When the couple moved to London, they purchased aerial photographs of the city and marked all of the flat-roof buildings in red ink. "We knew we had a good business idea when the whole picture was red," says Håkan. After conducting more research and building a business plan, the Olssons launched First Penthouse, a company specializing in rooftop development. Their business model adds value both for tenants, who get ritzy penthouse living quarters where none existed before, and for landlords, whose property values are enhanced by the addition of the modular penthouses. First Penthouse offers the convenience of one-day installation of its penthouses and guarantees no disturbances to existing residents. Like most entrepreneurs, the Olssons had to overcome obstacles, including banks that were hesitant to extend credit “because the idea was so new,” says Håkan. (To get the capital they needed, the Olssons used angel financing, a topic you will learn more about in Chapter 13, when they convinced a wealthy friend to put up most of the $400,000 they needed to create and install the first penthouse.) To convince balking regulators, the Olssons agreed to use special “quiet” tools and to place soundproof mats over the roofs on which they worked. Sales of the company’s penthouses are growing, and the Olssons are planning to take their concept into other large urban markets around the world, including New York City.13

The strategy section of the business plan should outline the methods the company can use to satisfy the key success factors required to thrive in the industry. If, for example, a strong, well-trained sales force is considered critical to success, the owner must devise a plan of action for assembling one. The foundation for this part of the business plan comes from the material in Chapter 3, “Designing a Competitive Business Model and Building a Solid Strategic Plan.”

**Description of the Firm’s Product or Service**

An entrepreneur should describe the company’s overall product line, giving an overview of how customers use its goods or services. Drawings, diagrams, and illustrations may be required if the product is highly technical. It is best to write product and service descriptions in a jargon-free style so that laypeople can understand them. A statement of a product’s position in the product life cycle might also be helpful. An entrepreneur should include a summary of any patents, trademarks, or copyrights protecting the product or service from infringement by competitors. Finally, it is helpful provide an honest comparison the company’s product or service with those of competitors, citing specific advantages or improvements that make the company’s goods or services unique and indicating plans for creating the next generation of goods and services that will evolve from the present product line.

The emphasis of this section should be on defining the unique characteristics of the company’s products or services and the benefits customers get by purchasing them, rather than on just a “nuts and bolts” description of the features of those products or services. A feature is a descriptive fact about a product or service (“An ergonomically designed, more comfortable handle”). A benefit is what a customer gains from the product or service feature (“Fewer problems with carpal tunnel syndrome and increased productivity”). Advertising legend Leo Burnett once said, “Don’t tell the people how good you make the goods; tell them how good your goods make them.”16 This part of the plan must describe how a business will transform tangible product or service features into important, but often intangible, customer benefits—for example, lower energy bills, faster access to the Internet, less time writing checks to pay monthly bills, greater flexibility in building floating structures, shorter time required to learn a foreign language, or others. Remember: Customers buy benefits, not product or service features.
Manufacturers should describe their production process, strategic raw materials required, sources of supply they will use, and their costs. They should also summarize the production method and illustrate the plant layout. If the product is based on a patented or proprietary process, a description (including diagrams, if necessary) of its unique market advantages is helpful. It is also helpful to explain the company’s environmental impact and how the entrepreneur plans to mitigate any negative environmental consequences the process may produce.

As the value of the automobiles Americans drive has increased, so has their desire to maintain the value of their cars by keeping them showroom clean. Some 75,000 car washes operate across the United States, but they vary drastically in terms of service and quality. Matthew Lieb and Chris Jones saw the opportunity to offer a superior car wash service and created Swash, a state-of-the-art, no-muss, no-fuss car wash in which customers select the services they want to purchase at an ATM-like machine and remain in their comfort of their vehicles. Cleaning services are delivered by software-controlled equipment that never lays a brush on the car and the process is environmentally friendly from start to finish—all in just five minutes.14

Stressing unique features such as these to investors can help to differentiate a product or process from those of competitors.

Marketing Strategy

One crucial concern of entrepreneurs and the potential lenders and investors who finance their companies is whether there is a real market for the proposed good or service. Every entrepreneur must therefore describe the company’s target market and its characteristics. Defining the target market and its potential is one of the most important—and most challenging—parts of building a business plan. Creating a successful business depends on an entrepreneur’s ability to attract real customers who are willing and able to spend real money to buy its products or services. Perhaps the worst marketing error an entrepreneur can commit is failing to define his or her target market and trying to make the business “everything to everybody.” Small companies usually are much more successful when focusing on a specific market niche where they can excel at meeting customers’ special needs or wants.

One technique for identifying potential target markets is to list all of the features your company’s product or service provides and then translate those features into a list of benefits (refer to the previous section). The next step is to develop a list of the types of people who need or could use those benefits. Be creative, and let your mind roam free. Once you have identified potential target markets, you can begin to research them to narrow the list down to the most promising one or two. Those are the markets your company should pursue.

One growing and evolving target market for small businesses is teenagers. By 2010, the number of teens will grow to 35 million (that’s nearly 12 percent of the U.S. population), but even more important than their numbers is this group’s purchasing power. According to Teenage Research Unlimited, teens spend $170 billion a year, an amount larger than the gross domestic products of Finland, Portugal, and Greece!5 Because they are not tied down with mortgage and car payments, most of teenagers’ spending is discretionary, an appealing fact for many savvy entrepreneurs looking to connect with this target market. The teen market also is important to businesses because teenagers exert strong influence over family purchases and tend to be early adopters of products and services that set societal trends. (Who were the early adopters of iPods? Teens.) “Young consumers are a very important market,” explains Mike Gatti, a top manager at the Retail Advertising and Marketing Association. “Young people have their own money and make their own buying decisions, and they are growing more important as society changes. Parents are getting more time starved, and they treat their children more like adults than previous generations of parents did.”16
Defining a company’s target market involves using the techniques described in more detail in Chapter 6, “Building a Marketing Plan,” but a business plan should address the following questions:

- Who are my target customers (age, gender, income level, and other demographic characteristics)?
- Where do they live, work, and shop?
- How many potential customers are in my company’s trading area?
- Why do they buy? What needs and wants drive their purchase decisions?
- What can my business do to meet those needs and wants better than my competitors?
- Knowing my customers needs, wants, and habits, what should be the basis for differentiating my business in their minds?

Proving that a profitable market exists involves two steps: showing customer interest and documenting market claims.

**Showing Customer Interest** An entrepreneur must be able to prove that his or her target customers need or want his or her good or service and are willing to pay for it. Two of the most reliable techniques involve building a working prototype of a product so that customers can see how it works and producing a small number of products so that customers can actually use them. An entrepreneur might offer a prototype or an actual product to several potential customers to get written testimonials and evaluations to show investors. Another way to get useful feedback is to sell the product to several customers at a discount. This would prove that there are potential customers for the product and would allow demonstrations of the product in operation. Getting a product into customers’ hands early in the process is also an excellent way to get valuable feedback that can lead to significant design improvements and increased sales down the road.

**Documenting Market Claims** Too many business plans rely on vague generalizations such as, “This market is so huge that if we get just 1 percent of it, we will break even in 8 months.” Statements such as this are not backed by facts and usually reflect an entrepreneur’s unbridled optimism. In most cases, they are also unrealistic! Market share determination is not obtained by a “shoot from the hip” generalization; on the contrary, sophisticated investors expect to see research that supports the claims an entrepreneur makes about the market potential of a product or service.

Providing facts about the sales potential of a product or service requires market research. Results of market surveys, customer questionnaires, and demographic studies lend credibility to an entrepreneur’s frequently optimistic sales projections. (You will learn more about market research techniques and resources in Chapter 7, “Building a Guerrilla Marketing Plan.”)
One of the goals of this section of the business plan is to lay the foundation for the financial forecasts that come later in the plan. A start-up company’s financial forecasts must be based on more than just wishful thinking. As much as possible, they should be built on research and facts. Many entrepreneurs build financial models for their potential business by applying information collected from trade or professional associations, local chambers of commerce, articles in magazines and newspapers, market studies conducted by themselves or others, government agencies, and, of course, the Web. With the availability of this volume of information, the sales, cost, and net income projections in a business plan should be a great deal more accurate than sketchy estimates scribbled on the backs of napkins.

This section of the business plan should address the following topics:

**Advertising.** Once an entrepreneur defines her or his company’s target market, she or he can design a promotion and advertising campaign to reach those customers most effectively and efficiently. Which media are most effective in reaching the target market? How will they be used? How much will the promotional campaign cost? How can the company benefit from publicity?

**Market size and trend.** How large is the potential market? Is it growing or shrinking? Why? Are the customer’s needs changing? Are sales seasonal? Is demand tied to another product or service?

**Location.** For many businesses, choosing the right location is a key success factor. For retailers, wholesalers, and service companies, the best location usually is one that is most convenient to their target customers. By combining census data and other market research with digital mapping software, entrepreneurs can locate sites with the greatest concentrations of their customers and the least interference from competitors. Which specific sites put the company in the path of its target customers? Do zoning regulations restrict the use of the site? For manufacturers, the location issue often centers on finding a site near its key raw materials or near its major customers. Using demographic reports and market research to screen potential sites takes the guesswork out of choosing the ideal location for a business.

**Pricing.** What does the product or service cost to produce or deliver? What is the company’s overall pricing strategy? What image is the company trying to create in the market? Will the planned price support the company’s strategy and desired image? (See Figure 4.4.) Can it produce a profit? How does the planned price compare to those of similar products or services? Are customers willing to pay it? What price tiers...
exist in the market? How sensitive are customers to price changes? Will the business sell to customers on credit? Will it accept credit cards?

**Distribution.** How will the product or service be distributed? What is the average sale? How many sales calls does it take to close a sale? What are the incentives for salespeople? What can the company do to make it as easy as possible for customers to buy?

This portion of the plan also should describe the channels of distribution that the business will use (mail, in-house sales force, sales agent, retailers). The owner should summarize the firm’s overall pricing and promotion strategies, including the advertising budget, media used, and publicity efforts. The company’s warranties and guarantees for its products and services should be addressed as well.

**Competitor Analysis**

An entrepreneur should discuss the new venture’s competition. Failing to assess competitors realistically makes entrepreneurs appear to be poorly prepared, naive, or dishonest, especially to potential lenders and investors. An analysis of each significant competitor should be presented. Entrepreneurs who believe they have no competitors are only fooling themselves and are raising a huge red flag to potential lenders and investors. Gathering information on competitors’ market shares, products, and strategies is usually not difficult. Trade associations, customers, industry journals, marketing representatives, and sales literature are valuable sources of data. This section of the plan should focus on demonstrating that the entrepreneur’s company has an advantage over its competitors. Who are the company’s key competitors? What are their strengths and weaknesses? What are their strategies? What images do they have in the marketplace? How successful are they? What distinguishes the entrepreneur’s product or service from others already on the market, and how will these differences produce a competitive edge? This section of the plan should demonstrate that the firm’s strategies are customer focused.

**Description of the Management Team**

The most important factor in the success of a business venture is the quality of its management, and financial officers and investors weigh heavily the ability and experience of the company’s managers in their financing decisions. Thus, a plan should describe the qualifications of business officers, key directors, and any person with at least 20 percent ownership in the company. Remember: Lenders and investors prefer experienced managers.
A management team with industry experience and a proven record of success goes a long way in adding credibility to the new venture.

When Jason Henry, Anil Nair, and Heath Seymour wrote the business plan for their company, Inkwell Fine Arts, LLC, a company that sells customized, high-quality art prints to interior designers over the Web, they emphasized the diverse and complementary backgrounds of their management team as well as their business experience. Seymour, an artist, manages the artistic and creative aspects of the business, Henry handles daily operations, and Nair oversees the Web site and the information technology components. With the three founders working in tandem, Inkwell Fine Arts is able to offer interior designers prints made to their specifications—the exact size, colors, and medium they need to decorate a client’s living or work space.

Résumés in a plan should summarize each key person’s education, work history (emphasizing managerial responsibilities and duties), and relevant business experience. When compiling a personal profile, an entrepreneur should review the primary reasons for small business failure (refer to Chapter 1) and show how the management team will use its skills and experience to avoid them. Entrepreneurs should not cover up previous business failure, however. Failing in business no longer has a terrible stigma attached to it. In fact, many investors are suspicious of entrepreneurs who have never experienced a business failure.

When considering investing in a business, lenders and investors look for the experience, talent, and integrity of the people who will breathe life into the plan. This portion of the plan should show that the company has the right people organized in the right fashion for success. One experienced private investor advises entrepreneurs to remember the following:

- **Ideas and products don’t succeed; people do.** Show the strength of your management team. A top-notch management team with variety of proven skills is crucial.
- **Show the strength of key employees and how you will retain them.** Most small companies cannot pay salaries that match those at large businesses, but stock options and other incentives can improve employee retention.
- **A board of directors or advisers consisting of industry experts lends credibility and can enhance the value of the management team.**

**Plan of Operation**

To complete the description of the business, the owner should construct an organizational chart identifying the business’s key jobs and the qualifications of the people occupying them. Assembling a management team with the right stuff is difficult, but keeping it together until the company is established may be harder. Thus, the entrepreneur should describe briefly the steps taken to encourage important officers to remain with the company. Employment contracts, shares of ownership, and perks are commonly used to keep and motivate such employees.

Finally, a description of the form of ownership (partnership, joint venture, S Corporation, LLC) and of any leases, contracts, and other relevant agreements pertaining to the business is helpful. (You will learn more about this topic in Chapter 5, “Organizational Issues and Forms of Ownership.”)

**Pro Forma (Projected) Financial Statements**

One of the most important sections of the business plan is an outline of the proposed company’s financial statements—the “dollars and cents” of the proposed venture. In fact, one survey found that 74 percent of bankers say that financial documentation is the most important aspect of a business plan for entrepreneurs seeking loans. For an existing
business, lenders and investors use past financial statements to judge the health of the company and its ability to repay loans or generate adequate returns; therefore, an owner should supply copies of the firm’s financial statements from the last three years. Ideally, these statements should be audited by a certified public accountant because most financial institutions prefer that extra reliability, although a financial review of the statements by an accountant sometimes may be acceptable.

Whether assembling a plan for an existing business or for a start-up, an entrepreneur should carefully prepare monthly projected (or pro forma) financial statements for the operation for the next year (and for two more years by quarter) using past operating data, published statistics, and research to derive three sets of forecasts of the income statement, balance sheet, cash forecast (always!), and a schedule of planned capital expenditures. (You will learn more about creating projected financial statements in Chapter 10, “Creating a Successful Financial Plan.”) The forecasts should cover pessimistic, most likely, and optimistic conditions to reflect the uncertainty of the future. When in doubt, be up front and include some contingencies for any costs that you are unsure about.

It is essential that all three sets of forecasts be realistic. Entrepreneurs must avoid the tendency to “fudge the numbers” just to make their businesses look good. Lenders and investors compare these projections against published industry standards and can detect unrealistic forecasts. In fact, some venture capitalists automatically discount an entrepreneur’s financial projections by as much as 50 percent. After completing these forecasts, an entrepreneur should perform a break-even analysis and a ratio analysis on the projected figures.

It is also important to include a statement of the assumptions on which these financial projections are based. Potential lenders and investors want to know how an entrepreneur derived forecasts for sales, cost of goods sold, operating expenses, accounts receivable, collections, accounts payable, inventory, taxes, and other items. Spelling out realistic assumptions gives a plan more credibility and reduces the tendency to include overly optimistic estimates of future profit margins. Greg Martin, a partner in the venture capital company Redpoint Ventures, says, “I have problems with start-ups making unrealistic assumptions—how much money they need or how quickly they can ramp up revenue. Those can really kill a deal for me.”

In addition to providing valuable information to potential lenders and investors, projected financial statements help entrepreneurs to run their businesses more effectively and more efficiently after the start-up. They establish important targets for financial performance and make it easier for an entrepreneur to maintain control over routine expenses and capital expenditures.

**The Loan or Investment Proposal**

The loan or investment proposal section of the business plan should state the purpose of the financing, the amount requested, and the plans for repayment or, in the case of investors, an attractive exit strategy. When describing the purpose of the loan or investment, an entrepreneur must specify the planned use of the funds. General requests for funds using terms such as “for modernization,” “working capital,” or “expansion” are unlikely to win approval. Instead, entrepreneurs should use more detailed descriptions such as “to modernize production facilities by purchasing five new, more efficient looms that will boost productivity by 12 percent” or “to rebuild merchandise inventory for fall sales peak, beginning in early summer.” Entrepreneurs should state the precise amount requested and include relevant backup data, such as vendor estimates of costs or past production levels. Entrepreneurs should not hesitate to request the amount of money needed but should not inflate the amount, anticipating the financial officer to “talk them down.” Remember: Lenders and investors are normally very familiar with industry cost structures.

Another important element of the loan or investment proposal is the repayment schedule and exit strategy. A lender’s main consideration in granting a loan is the reassurance that the applicant will repay, whereas an investor’s major concern is earning a
satisfactory rate of return. Financial projections must reflect a company’s ability to repay loans and produce adequate returns. Without this proof, a request for funding stands little chance of being approved. It is necessary for the entrepreneur to produce tangible evidence showing the ability to repay loans or to generate attractive returns. “Plan an exit for the investor,” advises the owner of a financial consulting company. “Generally, the equity investor’s objective with early stage funding is to earn a 30% to 50% annual return over the life of the investment. To enhance the investor’s interest in your enterprise, show how they can ‘cash out’ perhaps through a public offering or acquisition.”

Finally, an entrepreneur should have a timetable for implementing the proposed plan. He or she should present a schedule showing the estimated start-up date for the project and noting any significant milestones along the way. Entrepreneurs tend to be optimistic, so document how and why the timetable of events is realistic.

It is beneficial to include an evaluation of the risks of a new venture. Evaluating risk in a business plan requires an entrepreneur to walk a fine line, however. Dwelling too much on everything that can go wrong will discourage potential lenders and investors from financing the venture. Ignoring the project’s risks makes those who evaluate the plan tend to believe an entrepreneur to be naïve, dishonest, or unprepared. The best strategy is to identify the most significant risks the venture faces and then to describe the plans the entrepreneur has developed to avoid them altogether or to overcome the negative outcome if the event does occur.

There is a difference between a working business plan—the one the entrepreneur is using to guide the business—and the presentation business plan—the one he or she is using to attract capital. Although coffee rings and penciled-in changes in a working plan don’t matter (in fact, they’re a good sign that the entrepreneur is actually using the plan), they have no place on a plan going to someone outside the company. A plan is usually the tool that an entrepreneur uses to make a first impression on potential lenders and investors. To make sure that impression is a favorable one, an entrepreneur should follow these tips:

- Realize that first impressions are crucial. Make sure the plan has an attractive (not necessarily expensive) cover.
- Make sure the plan is free of spelling and grammatical errors and "typos." It is a professional document and should look like one.
- Make it visually appealing. Use color charts, figures, and diagrams to illustrate key points. Don’t get carried away, however, and end up with a “comic book” plan.
- Include a table of contents with page numbers to allow readers to navigate the plan easily. Reviewers should be able to look through a plan and quickly locate the sections they want to see.
- Make it interesting. Boring plans seldom get read.
- A plan must prove that the business will make money. In one survey of lenders, investors, and financial advisors, 81 percent said that, first and foremost, a plan should prove that a venture will earn a profit. Start-ups do not necessarily have to be profitable immediately, but sooner or later (preferably sooner), they must make money.
- Use computer spreadsheets to generate financial forecasts. They allow entrepreneurs to perform valuable “what if” (sensitivity) analysis in just seconds.
- Always include cash flow projections. Entrepreneurs sometimes focus excessively on their proposed venture’s profit forecasts and ignore cash flow projections. Although profitability is important, lenders and investors are much more interested in cash flow because they know that’s where the money to pay them back or to cash them out comes from.
- The ideal plan is “crisp,” long enough to say what it should but not so long that it is a chore to read.
- Tell the truth. Absolute honesty is always critical when preparing a business plan.
Write a Plan That Will Win You Money

At first, writing a business plan may seem like a daunting task, but like most big projects, the key to success is to take one step at a time. Often the toughest part is getting started! Entrepreneurs who take the time to research and write a business plan discover that, even though the plan itself is extremely useful for launching and managing their businesses and for raising capital, the real value lies in the process they go through to create the plan. Preparing a plan gives them a solid foundation from which to run their companies.

Another important use for a business plan is in raising the capital entrepreneurs need to launch their companies, a task that often proves to be quite challenging. How can you write a plan that will attract the capital you need to launch your business? The following tips will help.

Tip #1. Know your audience. As you write your plan, keep in mind your audience. Remember that potential lenders, private investors, venture capitalists, and other potential sources of funds receive hundreds of business plans a year. Most of them fail in two key areas: capturing the reader’s attention in a compelling way and spelling out how the business offers customers a product or service that is different or better in some way. Writing a business plan requires entrepreneurs to walk a fine line between being optimistic about the business’s market potential and realistically laying out the challenges and the risks involved. None of this matters, of course, if your executive summary fails to hook the reader in the first place. Be sure to invest plenty of time in honing the executive summary so that it communicates the basic business concept and its benefits in just a few sentences or paragraphs.

Tip #2. Know the elements of a business plan. The business plan outline and discussion in this chapter provide you with all of the elements a sound plan should contain. However, the way in which you organize and present them is up to you. Remember that because each entrepreneur and each business idea are unique, each business plan also should be unique. Don’t fall into the “cookie-cutter” trap. Cover the topics potential lenders and investors expect to see, but do it in your own style and in a way that is appropriate for your business.

Tip #3. Recognize the importance of strategy to your business success. Experienced lenders and investors know that the real key to building a successful company lies in creating and then executing a sound business strategy. Don’t give short shrift to explaining your company’s strategy for gaining a competitive edge in the plan. Experienced lenders and investors know that’s how a company achieves a sustainable record of success. Too often, entrepreneurs focus on creating financial forecasts without describing the strategies that will enable them to achieve those numbers.

Tip #4. Be thorough but not excessive. Potential lenders and investors want proof that entrepreneurs have done their homework—analyzing the industry, researching their target markets, studying the competition, and covering other important elements of a plan. However, they don’t want to wade through a lengthy tome to understand the essence of your business idea. Stay focused as you write, and limit your plan to no more than 40 pages if possible.

Tip #5. Be sure your financial forecasts are realistic. Experienced lenders and investors know that entrepreneurs tend to be optimists and that the financial projections they produce for their business plans also are optimistic. One of the fastest paths to having your business plan rejected is to include financial forecasts that are so optimistic that they are unreasonable. You may want to ask an accountant, a banker, or some other financial expert to review your financial forecasts before presenting your plan to potential lenders and investors.

Tip #6. Explain the exit strategy. Investors, in particular, are in the business of investing in start-up businesses for one reason: to make money when they cash out their ownership in the business. Any plan aimed at potential investors should explain how the company intends for investors to get their money back—preferably with a big return on their investments. Will the company make an initial public offering? Will it look to be bought out by a larger business? Potential lenders want to see evidence that the company will generate sufficient cash flow to be able to repay loans on time.
What Lenders and Investors Look for in a Business Plan

Banks usually are not a new venture’s sole source of capital because a bank’s return is limited by the interest rate it negotiates, but its risk could be the entire amount of the loan if the new business fails. Once a business is operational and has established a financial track record, however, banks become a regular source of financing. For this reason the small business owner needs to be aware of the criteria lenders and investors use when evaluating the creditworthiness of entrepreneurs seeking financing. Lenders and investors refer to these criteria as the **five Cs of credit**: capital, capacity, collateral, character, and conditions.

**Capital**
A small business must have a stable capital base before any lender is willing to grant a loan. Otherwise the lender would be making, in effect, a capital investment in the business. Most banks refuse to make loans that are capital investments because the potential for return on the investment is limited strictly to the interest on the loan, and the potential loss would probably exceed the reward. In fact, the most common reasons that banks give for rejecting small business loan applications are undercapitalization and too much debt. Banks expect a small company to have an equity base of investment by the owner(s) that will help to support the venture during times of financial strain, which are common during the start-up and growth phases of a business. Lenders and investors see capital as a risk-sharing strategy with entrepreneurs.

**Capacity**
A synonym for capacity is cash flow. Lenders and investors must be convinced of the firm’s ability to meet its regular financial obligations and to repay loans, and that takes cash. In Chapter 9, we will see that more small businesses fail from lack of cash than from lack of profit. It is possible for a company to be showing a profit and still have no cash—that is, to be technically bankrupt. Lenders expect small businesses to pass the test of liquidity, especially for short-term loans. Potential lenders and investors examine closely a small company’s cash flow position to decide whether it has the capacity necessary to survive until it can sustain itself.

**Collateral**
Collateral includes any assets an entrepreneur pledges to a lender as security for repayment of a loan. If the company defaults on the loan, the lender has the right to sell the collateral and use the proceeds to satisfy the loan. Typically, banks make very few unsecured loans (those not backed by collateral) to business start-ups. Bankers view the entrepreneurs’ willingness to pledge collateral (personal or business assets) as an indication of their dedication to making the venture a success. A sound business plan can improve a banker’s attitude toward a venture.

**Character**
Before extending a loan to or making an investment in a small business, lenders and investors must be satisfied with an entrepreneur’s character. The evaluation of character frequently is based on intangible factors such as honesty, integrity, competence, polish, determination, intelligence, and ability. Although the qualities judged are abstract, this evaluation plays a critical role in the decision to put money into a business or not.

Lenders and investors know that most small businesses fail because of incompetent management, and they try to avoid extending loans to high-risk entrepreneurs. A solid business plan and a polished presentation by the entrepreneur can go far in convincing the banker of the owner’s capability.
Conditions

The conditions surrounding a funding request also affect an entrepreneur’s chances of receiving financing. Lenders and investors consider factors relating to a business’s operation such as potential growth in the market, competition, location, strengths, weaknesses, opportunities, and threats. Again, the best way to provide this relevant information is in a business plan. Another important condition influencing the banker’s decision is the shape of the overall economy, including interest rate levels, inflation rate, and demand for money. Although these factors are beyond an entrepreneur’s control, they still are an important component in a banker’s decision.

The higher a small business scores on these five Cs, the greater its chance will be of receiving a loan. The wise entrepreneur keeps this in mind when preparing a business plan and presentation.

Making the Business Plan Presentation

Lenders and investors are favorably impressed by entrepreneurs who are informed and prepared when requesting a loan or investment. When attempting to secure funds from professional venture capitalist or private investors, the written business plan almost always precedes the opportunity to meet face to face. Typically, an entrepreneur’s time for presenting her or his business opportunity will be quite limited. (When presenting a plan to a venture capital forum, the allotted time is usually no more than 15 to 20 minutes, and at some forums, the time limit is a mere 5 or 6 minutes.). When the opportunity arises, an entrepreneur must be well prepared. It is important to rehearse, rehearse, and then rehearse more. It is a mistake to begin by leading the audience into a long-winded explanation about the technology on which the product or service is based. Within minutes most of the audience will be lost; and so is any chance the entrepreneur has of obtaining the necessary financing for her or his new venture.

Dick Bardow sat quietly in his car, pondering why he had failed to convince Pat Guinn, managing partner of Next Century Venture Capital, to provide the start-up capital he needed to launch the business that would present his new high-tech medical invention. Bardow had spent the past three-and-a-half years researching and developing the concept, and now that he had a product in hand, he was ready to take it to the market. The idea for Bardow’s new venture had been simmering for many years during his stints as a researcher for a major medical lab and as a technical advisor for a medical products company. Bardow had learned a great deal about use of the end product in his technical job, which he took after earning a Master’s degree in Biomedical Engineering. But it was during his tenure at the medical lab that Bardow saw the importance of staying on the cutting edge of technology in the field of medicine. He also saw the tremendous profit potential of successful medical products.

Driving home, Bardow replayed his meeting with Guinn in his mind. “How could those venture capitalists have missed the tremendous opportunity right in front of them?” he mused. During his 45-minute meeting with Guinn and her staff, Bardow had spent 30 minutes explaining how the technology had evolved over time, how he had developed the product, and why it was technologically superior to anything on the market. “I’ve got them where I want then, now,” he remembers thinking. “They can’t help
Helpful tips for making a business plan presentation to potential lenders and investors include the following:

- Demonstrate enthusiasm about the venture, but don’t be overemotional.
- Know your audience thoroughly, and work to establish a rapport with them.
- “Hook” investors quickly with an up-front explanation of the new venture, its opportunities, and the anticipated benefits to them.
- Hit the highlights; specific questions will bring out the details later. Don’t get caught up in too much detail in early meetings with lenders and investors.
- Keep your presentation simple by limiting it to the two or three (no more) major points you must get across to your audience.
- Avoid the use of technological terms that will likely be above most of the audience. Do at least one rehearsal before someone who has no special technical training. Tell that person to stop you anytime he or she does not understand what you are talking about. When this occurs (and it likely will) rewrite that portion of your presentation.
- Use visual aids. They make it easier for people to follow your presentation, but do not make the visual aids the “star” of the presentation. They should merely support and enhance your message.
- Close by reinforcing the nature of the opportunity. Be sure you have sold the benefits the investors will realize when the business is a success.
- Be prepared for questions. In many cases, there is seldom time for a long “Q&A” session, but interested investors may want to get you aside to discuss the details of the plan.
- Follow up with every investor to whom you make a presentation. Don’t sit back and wait; be proactive. They have what you need—investment capital. Demonstrate that you have confidence in your plan and have the initiative necessary to run a business successfully.

But see the incredible power of this technology.” Throughout his corporate career, Bardow had earned a reputation for his ability to explain abstract ideas and highly technical concepts to his fellow scientists. Over the years, he had made dozens of presentations at scientific professional meetings, all of which were well received.

Bardow had to admit, however, that he was puzzled by all of the questions Guinn had asked him toward the end of their meeting. They weren’t at all what he was expecting! “She never asked a single question about my product, its design, the technology behind it, or the patent I have pending,” he muttered. He remembered her questioning him about a “market analysis” and how and to whom he planned to market his product. “How foolish!” he thought. “You can’t forecast exact sales for a new product. Once this product is on the market and the medical industry sees what it can do, we’ll have all the sales we’ll need—and more.” Bardow was convinced that Guinn simply didn’t understand that new, innovative products create their own markets. “I’ve seen it dozens of times,” he said. Dick was beginning to believe that venture capital firms were too focused on revenues, profits, and return on investment. “Don’t they know that those things are outcomes?” he thought. “They come . . . in time.”

1. Identify the possible problems with Dick Bardow’s presentation of his business plan to Pat Guinn and the other venture capitalists.
2. Should potential lenders and investors evaluate new ventures that are based on cutting-edge technology differently from other business ventures? Explain.
3. List at least five suggestions you would make to Dick Bardow to improve his business plan and his presentation of it.
In 1984, two MBA students at the University of Texas thought that an experience to teach entrepreneurship in the same comprehensive way that “moot court” competitions taught law would be a good idea. They approached some of their professors and soon launched Moot Corp., the country’s first business plan competition in which students competed not only for pride but also for start-up capital to launch their businesses. In 1989, the Massachusetts Institute of Technology started the MIT $10K (now $50K) Entrepreneurship Competition, and many other colleges and universities have followed suit with business plan competitions of their own. “In the 1980s and even in the 1990s, putting on a competition like this was a radical concept,” says Randy Swangard, director of the New Venture Championship, a business plan competition started in 1991 at Lundquist College.

Today dozens of colleges and universities across the United States sponsor business plan competitions, and it is not uncommon for the winners to attract impressive amounts of venture capital from judges. “I have been amazed at the quality of the plans and the companies coming out of these competitions,” says Steve Kaplan of the University of Chicago. One student team that recently won the $20,000 first prize at the University of Pennsylvania’s Wharton Business Plan Competition spotted an opportunity in the health care industry based on the research of team leader Dhavel Gosalia, a doctoral student in bioengineering. The team’s plan for FibrinX is based on the fact that fish blood clots more readily than mammalian blood. FibrinX plans to market a tissue sealant derived from the blood plasma of the Atlantic salmon that stimulates and enhances the human body’s natural blood-clotting process for treating patients with serious injuries or those undergoing surgery. Because fish show no tendencies for transmitting blood-borne diseases such as AIDS and hepatitis, FibrinX’s product offers another key advantage: safety.

One winning team at Harvard’s business plan competition also went on to launch the company for which they created the plan, Chemdex, an e-commerce site that buys and sells life science products. The young entrepreneurs raised $13 million from one of the nation’s best-known venture capital firms and later made a public stock offering . . . and it was only a runner-up in the competition! The winning company was an Internet consulting company named Zefer that attracted $100 million in start-up capital, the largest private funding ever for an Internet start-up.

Faculty and students alike find the idea of business plan competitions appealing because they provide an all-encompassing educational experience. As they prepare their plans, students learn a comprehensive set of business skills, ranging from conducting industry and market research and assembling a new venture team to developing realistic financial forecasts and writing mission statements. They also learn valuable skills as they present their plans to panels of judges that often comprise successful entrepreneurs, bankers, venture capitalists, and other business heavy-hitters. “If you want to launch an entrepreneurship program at your business school,” advises Gary Cadenhead, director of Moot Corp., “it makes sense to start a business plan competition because students learn topics such as intellectual property and trademarks, venture capital, and guerrilla marketing.” Two valuable lessons that often come from business plan competitions are that it takes more than just a good idea to build a successful business venture and that building a business is hard work.

One of the largest business plan competitions is the Venture Bowl, founded by entrepreneur and venture capitalist David Geliebter. Open to any start-up team with a member who is a part-time or full-time student at any college or university in North America, Venture Bowl offers big prize money: $500,000 for first place, $250,000 for second place, and $125,000 each for two third-place finishers. In one recent Venture Bowl competition, Harvard University students Michelle Crames and Jeff Norton beat out hundreds of challengers to take the first-place prize with their business plan for Lean Forward Media, an interactive media company that holds the exclusive home entertainment rights to the Choose Your Own Adventure® series of children’s books. “Venture Bowl has been an
extraordinary experience for us,” says Norton. “It gave us the opportunity to showcase ourselves and our company to a stellar group of judges who provided invaluable advice.” Since winning the competition, Crames and Norton have launched Lean Forward with the goal of adapting to DVD the popular books’ idea of allowing readers to determine the ending by making decisions for the main character (“you") along the way. “Lean Forward Media is a wonderful example of the entrepreneurial spirits that exists on America’s campuses,” says Geliebter.

According to one business writer, “Business plan competitions remind would-be entrepreneurs that success requires a solid business plan even more than a bountiful bank balance. Once students have truly learned that business basic, they’re not only better prepared to play the entrepreneurial game, they’re more likely to end up as winners.”

1. If your school does not already have a business plan competition, work with a team of your classmates in a brainstorming session to develop ideas for creating one. What would you offer as a prize? How would you finance the competition? Whom would you invite to judge it? How would you structure the competition?

2. Use the World Wide Web to research business plan competitions at other colleges and universities across the nation. Using the competitions at these schools as benchmarks and the ideas you generated in Question 1, develop a format for a business plan competition at your school.

3. Assume that you are a member of a team of entrepreneurial students competing in a prestigious business plan competition. Outline your team’s strategy for winning the competition.


Conclusion

Although there is no guarantee of success when launching a business, the best way to insure against failure is create a business plan. A good plan serves as an entrepreneurial strategic compass that keeps a business on course as it travels into an uncertain future. In addition, a solid plan is essential to raising the capital needed to start a business; lenders and investors demand it. It is absolutely essential for the business plan to be built on facts and realistic assumptions. Nothing destroys an entrepreneur’s credibility faster than a document or presentation that lacks substance and is viewed by potential investors as a complete fabrication or an exercise in wishful thinking.

Business Plan Format

Although every company’s business plan will be unique, reflecting its individual circumstances, certain elements are universal. The following outline summarizes these components:

I. Executive Summary (not to exceed two pages)
   A. Company name, address, and phone number
   B. Name, address, and phone number of all key people
   C. Brief description of the business, its products and services, and the customer problems they solve
   D. Brief overview of the market for your products and services
   E. Brief overview of the strategies that will make your firm a success
   F. Brief description of the managerial and technical experience of key people
   G. Brief statement of the financial request and how the money will be used
   H. Charts or tables showing highlights of financial forecasts
II. Vision and Mission Statement
   A. Entrepreneur’s vision for the company
   B. “What business are we in?”
   C. Values and principles on which the business stands
   D. What makes the business unique? What is the source of its competitive advantage?

III. Company History (for existing businesses only)
   A. Company founding
   B. Financial and operational highlights
   C. Significant achievements

IV. Business and Industry Profile
   A. Industry analysis
      1. Industry background and overview
      2. Significant trends
      3. Growth rate
      4. Key success factors in the industry
   B. Outlook for the future stages of growth (start-up, growth, maturity)
   C. Company goals and objectives
      1. Operational
      2. Financial
      3. Other

V. Business Strategy
   A. Desired image and position in market
   B. SWOT analysis
      1. Strengths
      2. Weaknesses
      3. Opportunities
      4. Threats
   C. Competitive strategy
      1. Cost leadership
      2. Differentiation
      3. Focus

VI. Company Products and Services
   A. Description
      1. Product or service features
      2. Customer benefits
      3. Warranties and guarantees
      4. Uniqueness
   B. Patent or trademark protection
   C. Description of production process (if applicable)
      1. Raw materials
      2. Costs
      3. Key suppliers
   D. Future product or service offerings

VII. Marketing Strategy
   A. Target market
      1. Complete demographic profile
      2. Other significant customer characteristics
   B. Customers’ motivation to buy
   C. Market size and trends
      1. How large is the market?
      2. Is it growing or shrinking? How fast?
D. Advertising and promotion
   1. Media used—reader, viewer, listener profiles
   2. Media costs
   3. Frequency of usage
   4. Plans for generating publicity

E. Pricing
   1. Cost structure
      a. Fixed
      b. Variable
   2. Desired image in market
   3. Comparison against competitors’ prices

F. Distribution strategy
   1. Channels of distribution used
   2. Sales techniques and incentives

VIII. Location and Layout
   A. Location
      1. Demographic analysis of location versus target customer profile
      2. Traffic count
      3. Lease/rental rates
      4. Labor needs and supply
      5. Wage rates
   B. Layout
      1. Size requirements
      2. Americans with Disabilities Act compliance
      3. Ergonomic issues
      4. Layout plan (suitable for an Appendix)

IX. Competitor Analysis
   A. Existing competitors
      1. Who are they? Create a competitive profile matrix.
      2. Strengths
      3. Weaknesses
   B. Potential competitors: companies that might enter the market
      1. Who are they?
      2. Impact on your business if they enter

X. Description of Management Team
   A. Key managers and employees
      1. Their backgrounds
      2. Experience, skills, and know-how they bring to the company
   B. Résumés of key managers and employees (suitable for an Appendix)

XI. Plan of Operation
   A. Form of ownership chosen and reasoning
   B. Company structure (organization chart)
   C. Decision-making authority
   D. Compensation and benefits packages

XII. Financial Forecasts (suitable for an Appendix)
   A. Financial statements
      1. Income statement
      2. Balance sheet
      3. Cash flow statement
   B. Break-even analysis
   C. Ratio analysis with comparison to industry standards (most applicable to existing businesses)
XIII. Loan or Investment Proposal
   A. Amount requested
   B. Purpose and uses of funds
   C. Repayment or “cash-out” schedule (exit strategy)
   D. Timetable for implementing plan and launching the business

XIV. Appendices—Supporting documentation, including market research, financial statements, organization charts, resumes, and other items.

Chapter Summary by Learning Objectives

1. Discuss the steps involved in subjecting a business idea to a feasibility analysis.
   A feasibility analysis consists of three interrelated components: an industry and market feasibility analysis, a product or service feasibility analysis, and a financial feasibility analysis. The goal of the feasibility analysis is to determine whether an entrepreneur’s idea is a viable foundation for creating a successful business.

2. Explain why every entrepreneur should create a business plan, as well as the benefits of developing a plan.
   A business plan serves two essential functions. First and most important, it guides the company’s operations by charting its future course and devising a strategy for following it. The second function of the business plan is to attract lenders and investors. Applying for loans or attempting to attract investors without a solid business plan rarely attracts needed capital.
   Preparing a sound business plan clearly requires time and effort, but the benefits greatly exceed the costs. Building the plan forces a potential entrepreneur to look at her or his business idea in the harsh light of reality. It also requires the owner to assess the venture’s chances of success more objectively. A well-assembled plan helps prove to outsiders that a business idea can be successful.
   The real value in preparing a business plan is not so much in the plan itself as it is in the process the entrepreneur goes through to create the plan. Although the finished product is useful, the process of building a plan requires an entrepreneur to subject her or his idea to an objective, critical evaluation. What the entrepreneur learns about the company, its target market, its financial requirements, and other factors can be essential to making the venture a success.

3. Describe the elements of a solid business plan.
   Although a business plan should be unique and tailor-made to suit the particular needs of a small company, it should cover these basic elements: an executive summary, a mission statement, a company history, a business and industry profile, a description of the company’s business strategy, a profile of its products or services, a statement explaining its marketing strategy, a competitor analysis, owners’ and officers’ résumés, a plan of operation, financial data, and the loan or investment proposal.

4. Explain the “five Cs of credit” and why they are important to potential lenders and investors reading business plans.
   Small business owners needs to be aware of the criteria bankers use in evaluating the credit-worthiness of loan applicants—the five Cs of credit: capital, capacity, collateral, character, and conditions.
   Capital—Lenders expect small businesses to have an equity base of investment by the owner(s) that will help to support the venture during times of financial strain.
   Capacity—A synonym for capacity is cash flow. The bank must be convinced of the firm’s ability to meet its regular financial obligations and to repay the bank loan, and that takes cash.
   Collateral—Collateral includes any assets the owner pledges to the bank as security for repayment of the loan.
   Character—Before approving a loan to a small business, the banker must be satisfied with the owner’s character.
   Conditions—The conditions—interest rates, the health of the nation’s economy, industry growth rates, and so on—surrounding a loan request also affect the owner’s chance of receiving funds.

5. Describe the keys to making an effective business plan presentation.
   Lenders and investors are favorably impressed by entrepreneurs who are informed and prepared when requesting a loan or investment.
   Tips include: Demonstrate enthusiasm about the venture, but don’t be overemotional; “hook” investors quickly with an up-front explanation of the new venture, its opportunities, and the anticipated benefits to them; use visual aids; hit the highlights of your venture; don’t get caught up in too much detail in early meetings with lenders and investors; avoid the use of technological terms that will likely be above most of the audience; rehearse your presentation before giving it; and be prepared for questions.
CHAPTER 4 • CONDUCTING A FEASIBILITY ANALYSIS AND CRAFTING A WINNING BUSINESS PLAN

Discussion Questions

1. Explain the steps involved in conducting a feasibility analysis.
2. Why should an entrepreneur develop a business plan?
3. Describe the major components of a business plan.
4. How can an entrepreneur seeking funds to launch a business convince potential lenders and investors that a market for the product or service really does exist?
5. How would you prepare to make a formal presentation of your business plan to a venture capital forum?
6. What are the 5 Cs of credit? How does a potential lender use them to evaluate a loan request?

Business Plan Pro

This chapter on the creation of a successful business plan is designed to test your business concept. The following exercises will assist you in validating or challenging your business concept. You will also begin to work through the situation analysis part of your plan to better understand your market. Be as objective as possible as you work through these exercises. Rely on your ability to gather information and make realistic assessments and projections as the exercises require.

Business Plan Exercises

On the Web
Go to http://www.prenhall.com/scarborough to the Business Plan Resource tab. If you have not done this yet, find the Standard Industry Classification (SIC) Code associated with your industry. You will find a link in the SIC Code information that will connect you to a resource to help you do that. Explore the information and links that are available to you on that site to learn more about the size of the industry and its growth, trends, and issues. Based on the industry you have selected and the associated SIC code, apply Porter’s five forces model. Consider the five forces—the bargaining power of buyers, the power of suppliers, the threat of new entrants, the threat of substitute products, and the level of rivalry. Again, you will find additional information on Porter’s five forces model in the “Strategy” section of this same site. Look for information on the Web that may assist you with this analysis. Based on this information, how attractive do you consider this industry? How would you assess the opportunity this industry presents? Does this information encourage you to become involved in this industry, or does it highlight significant challenges?

In the Software
Your text may have come with Business Feasibility Analysis Pro. This software is designed to take you through the essential steps of assessing the feasibility of your business concept. It addresses the overall feasibility of your product or service, helps you to conduct an industry assessment, reviews your management skills, and steps through a preliminary financial analysis. The software provides “feedback” based on your input through four components of the feasibility analysis with a numerical assessment. You can then export this information directly into Business Plan Pro.

Business Plan Pro will also be a good resource to help you assess the feasibility of your business concept in the areas of product, service, market organization, and financial feasibility. For example, you can enter the initial capital requirements for the business in the start-up and expenses section. Your sales forecast will help to predict the revenue that may be generated, and this will help to determine your return on investment. If you have these estimates available, enter those into your plan. Based on that information, refer to the Profit and Loss statement. At what point, if any, does that statement indicate that your venture will begin generating a profit based on those forecasts and expenses. In what year does that occur? Do you find that amount of time acceptable? If you are seeking investors, will they find that timeframe acceptable? Is the return on investment promising, and does this venture merit taking on the associated level of risk? We will talk more about these sections of your plan as you progress through the chapters.

Sample Plans
Review the start-up sample plans called “IntelliChild.com” and “Fantastic Florals.”

1. What was the total amount of the start-up investment for each of these plans?
2. At one point—in months or years—did the plan indicate that it would begin making a profit?
3. What was the total profit that was projected in the year following this point?
4. Based on the break-even point, which of these ventures do you find most attractive?
5. Based the projections by year three, which plan appears to offer the greatest financial potential?
6. How does the scale and potential of these two opportunities compare to those in your plan?
Building Your Business Plan
Review the information in Market Analysis section. Continue to build your information in this section based on the outline. Now, go to Sales Strategy section and you will find information to help you to project your expenses. You may enter your numbers in the table itself or use the Wizard that will pop up to assist you with this process. You can manipulate the visual graph to build that forecast based on a visual growth curve or enter the actual data. If your business is a start-up venture, your expenses will include those figures along with your ongoing expense projections. At this point, don’t worry about the accuracy of your projection. Enter data into the software; you can change those numbers at any time. Look at the Profit and Loss statement. Do you find that acceptable? At what point in time will your business begin making a profit?

As you build your plan, you will want to check to see that the outline and structure of your plan are a good fit to tell your story. Although the outline in Business Plan Pro is not identical to the outline presented in the chapter, by “right clicking” on the outline, you can move, add, and delete any topic you choose to modify the plan you create.

Beyond the Classroom . . .

1. Contact a local entrepreneur who recently launched a business. Did he or she prepare a business plan before starting the company? Why or why not? If the entrepreneur did not create a plan, is he or she considering doing so now? If the entrepreneur did create a plan, what benefits did he or she gain from the process? How long did it take to complete the plan? How did he or she put the plan to use during the start-up phase? Does he or she intend to keep the business plan updated? What advice does he or she have to offer another entrepreneur about to begin writing a business plan?

2. Interview a local banker who has experience in making loans to small businesses. Ask him or her the following questions.
   A. How important is a well-prepared business plan?
   B. How important is a smooth presentation?
   C. How does the banker evaluate the owner’s character?
   D. How heavily does the bank weigh the five Cs of credit?
   E. What percentage of small business owners are well prepared to request a bank loan?
   F. What are the most common reasons the bank rejects small business loan applications?

3. Interview a small business owner who has requested a bank loan or an equity investment from external sources. Ask him or her these questions:
   A. Did you prepare a written business plan before approaching the financial officer?
   B. If the answer is “yes,” did you have outside or professional help in preparing it?
   C. How many times have your requests for additional funds been rejected? What reasons were given for the rejection?