Appendix 3

WRITING A WINNING BUSINESS PLAN

To help entrepreneurs turn the knowledge this book has presented into fruitful action, this appendix will give practical advice on how to develop an effective business plan.

General Advice for Entrepreneurs

Before we analyze the business plan, which is often one of the most time-consuming aspects of the fund raising process, let’s review some general pieces of advice that every entrepreneur should follow based on our extensive review of the entrepreneurship literature and the feedback we received from successful entrepreneurs.

• Know when to seek outside funds
The acquisition of equity capital should be a strategic decision, undertaken when a firm has verified its growth potential and found a real need for funds. The longer an entrepreneur waits to raise funds, the better. Once a firm has a track record, the less equity the entrepreneur will have to surrender for outside money. Bootstrapping and personal funds are good ways to build a firm to position it for outside investors. In today’s Internet craze, however, high-tech start-ups have the rare luxury of seeking outside investors when their ideas are just in their infancy because of the unprecedented investor interest in their sector.

• Decide how much you are willing to surrender
Before initiating the search for funds, entrepreneurs should determine roughly how much they are willing to compensate in the form of firm equity to attract an outside investor. Having realistic expectations of the costs of finance avoids surprises and potential wasted effort later on.

• Determine the ideal investor for your firm
Different types of investors have different benefits and disadvantages, as this book has clearly shown. Entrepreneurs in search of an outside investor should determine whether financial input is all they desire, or whether experienced management advice or a new co-worker is also a high priority. For those firms in their early stages, in addition to finance, business angels may offer many hands-on benefits which venture capitalists cannot. But more mature firms, which have built a track record in a fast-growing market and have a balanced management team, may benefit more from the large cash infusion and strategic guidance of a venture capitalist. Clearly, entrepreneurs need to first assess their own firm (stage, growth potential, market, competition, management team) to determine which type of investor they are most able to secure, and then decide what they need in such an investor beyond the infusion of funds. Recruiting investors who understand your industry will give you added support, guidance and empathy if your industry takes a seasonal slump or your firm struggles to be competitive in its market.
• **Use your network contacts**
To find potential investors, particularly business angels, entrepreneurs must exploit their business and personal networks to the fullest, as detailed in Chapter 5. With many potential angels in your geographic area, ‘getting the word out’ is often the best way to find an interested investor. Alternatively, formal matching services can be approached, although they remain at this time a factor in only a small minority of funding matches. To lure venture capitalists, a professional referral is mandatory to gain attention.

• **Refine your sales pitch**
Different investors are motivated by different things, as we thoroughly discussed throughout this book, particularly Chapter 7. Before appealing to the investor type of your choice, know what in general motivates them most and then tailor your business plan and sales pitch accordingly. If you are fortunate to already have a specific investor in mind, be it an angel of a venture capitalist, find out what their interests are, other ventures they have funded recently, and their primary criteria and tailor your plan to emphasize these features. Angels often seek excitement and the opportunity to use their own creativity and skills – make sure that your investment opportunity embodies these requirements. Should this particular approach not work for the investor you had in mind, find another investor—there are plenty of fish in the sea!

• **Emphasize the uniqueness of your firm**
No investor wants to invest their hard-earned dollars into a firm lacking some unique aspect which will set it apart from the competition and have the edge that may potentially bring in millions in revenue. Entrepreneurs should communicate their unique vision for the firm and go to pains to clarify its competitive position. A unique edge of some sort is of vital importance.

• **Emphasize the ‘people aspects’ of your firm**
Investors tend to invest more in people than in ideas. A stellar entrepreneur with a lackluster idea, though not ideal, will have the smarts and experience to change things around to attain success. For angel investors, especially, who often want to work with the entrepreneur, having confidence in the entrepreneur is one of the most important characteristics to attract investment. If the people do not have (and can show) a high degree of integrity, motivation and experience, investors will usually pass on the deal.

• **Know your limitations**
If attempts to attract an outside investor result in an entrepreneur modifying his/her business plan and venture’s outlook beyond what he/she is comfortable with, the entrepreneur has to decide whether acquiring an outside investor is really worth it, and whether the right type of investors have been focussed on thus far. If an entrepreneur is not entirely happy with what is being presented to potential investors, it may certainly be a cause for aggravation at a later stage, after the funds have been secured.

• **Borrow added credibility**
Start-up firms and their young entrepreneurs often lack credibility. Though this is an inherent part of the situation, it can be partly overcome by securing support and backing from more experienced and credible outside individuals. First, an entrepreneur may establish a board of directors and fill it with a number of talented and experienced outsiders who can lend their advice and reputations within the community to the young unproven venture. Second, a board of technical advisors may be established, especially for those more technical of firms, to lend added insight and credibility. Third, entrepreneurs should create professional advisory relationships with respected legal and accounting firms. Forwarding financial statements which have been verified by a respected ‘Big Six’ accounting firm can certainly lend added credibility and comfort to investors and others. If you negotiate hard, the fees for such an accounting firm may not be much higher than for a no-name firm (Welles, 1994). Fourth, any public relations a small firm can get is an added bonus. Though getting featured in a national publication, such as Forbes, may be unlikely, news coverage in trade magazines and the local press can certainly help to expose the business and possibly attract potential investors, or at least give the firm added credibility to lure investors. Fifth, if a firm already has outside equity investors, this can improve the odds of gaining a second round of funds from angels, venture capitalists, and even banks. Already having some sort of outside backing adds credibility to the venture – ‘if others have seen fit to invest in the firm, then my hunch may be right’.

- **Follow a rifle shot approach (leave the shotgun at home)**
  When selecting angel investors to approach, select only a few (who may be potentially interested) to approach. Tailoring your sales pitch to just a few (in whom you are interested as well) is a more surefire road to funding success, than using a shotgun approach to reach many investors at once. Quality over quantity rules in the search for equity funds. Additionally, if a shotgun attempt at seeking finance is not received favorably by angels in your area, it will be difficult to go back to some of them later with a more refined and tailored second attempt. Similarly, when approaching venture capitalists, make sure that you use a referral source for each investment firm considered, and tailor your approach to their investment requirements and motivations. This is particularly important in the highly-inbred venture capital community because one rejection of a business plan usually reduces the chances that other venture capitalists will find it attractive.

- **Target lead investors**
  Increasingly, angels are investing in groups to allow more diversification of risk and skills and to afford larger investment opportunities otherwise outside of their grasp. In every such angel syndicate, there is at least one prominent investor who the others respect and follow. Entrepreneurs must try to target these individuals and gain their approval. Similarly, in venture capital firms, where investment decisions are made in committees, targeting a particular partner who is seen as more sympathetic may allow the entrepreneur to gain an internal champion and build momentum (Wasserman, 1999). Also, there are often patterns of deference between different venture capital firms, where support by one firm can increase the support from others.

- **Get your foot in the door**
Most investment opportunities seen by business angels and venture capitalists are rejected before they even meet the entrepreneur. If an entrepreneur can gain an investor’s attention, then the chances of securing funds have already increased dramatically (Riding, 1998).

- **Check out potential investors**
  Due diligence is a two-way street. Although entrepreneurs may be hesitant to check out potential investors for fear of possibly turning away committed funds, it is imperative that they learn as much as possible about the person to whom they are selling part of their company.

  *Questions every entrepreneur should ask:*
  - Are the investor’s motivations in line with what we can realistically offer?
  - Is the investor’s personality compatible with mine?
  - Does the investor share the same goals as me?
  - What other firms has the investor funded in the past?
  - How did these turn out?
  - How active was the investor in those firms?
  - Did the investor make constructive contributions?
  - What do entrepreneurs in those firms (especially those that failed) say about the investor?
  - Did the investor stick with these firms in times of trouble?
  - What industries does the investor have experience in?
  - Does the investor understand this firm’s industry sector and can he/she contribute to this area?
  - How helpful will this investor be in trying to obtain future rounds of financing?
  - Does this investor have the expertise, contacts, and reputation to attract other potential investors and build the firm?

- **Set guidelines with your investors**
  Before the investment agreement is drawn up, the entrepreneur and investor must establish guidelines to clarify each person’s role in the venture. The timing and amount of assistance from the investor should be agreed upon so that the entrepreneur will know realistically how much value-added assistance to expect, and the investor will feel as if there is a role to play in the firm. Lay it all out on the table before signing on the dotted line.

- **Set up a formal communication channel**
  Once the investment has been made, the entrepreneur should establish a formal channel of communication so that contact with investor(s) remains frequent and can lead to valuable assistance from investors (Gruner, 1998).

- **Be persistent**
  Although most investors are very choosy about the deals they fund, it is important to remember that there are at least a few committed investors out there for every deal. If negotiations with one
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Investor do not turn out as planned, ask them to kindly refer your investment opportunity to another potentially-interested investor they know. Angels are often quite happy to do this (Riding, 1998), especially if the opportunity was rejected by them due to lack of sector knowledge or inability to contribute certain investor skills. Persistence pays - often very handsomely in the pursuit of entrepreneurial funds.

• Conduct a reality check
If multiple attempts for funds fail, the investment opportunity may not yet be developed enough to seek outside funds. Reliance upon other sources may be more appropriate for the time being. If continued attempts fail over time, it is important to recognize that all the money in the world may not be able to save a bad idea.

Steps to Writing a Persuasive Business Plan

Crafting a good business plan is a difficult task, usually involving weeks (if not months) of endless drafting and re-drafting. But a clear and professional plan is crucial for any business since it is the main selling tool in the fund raising process. A good business plan must make an immediate impact if it is to gain interest and follow-up. Potential investors often receive dozens, if not hundreds, of proposals per month. Luckily for first-time entrepreneurs, many books have been written on how to put together a good business plan. Many of these sources are, in our opinion, quite excellent and are certainly very comprehensive. We could make up our own guide here, but we do not think that we could necessarily do any better. The internet alone offers countless free (and excellent) business plan guides and any local book store will offer a wide selection too. Take a look through them and decide which style of plan is most to your liking - but remember to keep it short and concise! For starters, we urge entrepreneurs to review some of the sources that we liked:


Try the internet too:

Most of these guides are not written with business angel investors in mind, rather banks and venture capitalists are more common funding targets. In light of this, let's look at some of the aspects of a general business plan that should be emphasized depending upon the type of investor sought.

- **What business angels particularly look for in a business plan**
  - An opportunity to add their own skills and creativity to the venture
  - A trustworthy entrepreneur with a compatible personality
  - A firm in a niche market
  - An early-stage venture whose development they can still shape
  - Healthy financial projections
  - A venture which is within driving distance for the investor

- **What venture capitalists particularly look for in a business plan**
  - An experienced and well-balanced management team with a sound track record
  - A firm with a unique concept/idea that meets an unmet consumer need
  - A target market with almost unlimited growth potential
  - A proven niche product with almost unlimited growth potential
  - Strong competitive position
  - Very healthy, but realistic, financial projections
  - A firm which is usually more developed and looking for expansion funds (not a start-up)
  - Preferably a high-tech firm, but will entertain firms in other sectors
  - Detailed financial statements (preferably with milestone charts)
  - A potential equity stake of around 30% of the company in exchange for funds (though there is much variation)
  - Potential exit routes identifiable at time of investment

- **What every business plan should have**
  Different business plan manuals stress different content styles and there is no universal best. Depending upon their own preferences and types of businesses, entrepreneurs should select the
style which most appeals to them and will allow them to present their opportunity in the best light. But, in general, all business plans tend to be variations of the one we feature here, which happens to be a simpler variation of a plan featured by the Small Business Development Center – one which we particularly favored:

A Sample Table of Contents for a Business Plan

- Cover Letter
- Cover Sheet
- Table of Contents
- Executive Summary
  - Business concept
    - Name
    - Product/service
    - Market and competition
    - Management experience/expertise
  - Business goals
  - Summary of financial needs
  - Earnings projections
- Market Analysis
  - Total market analysis
  - Industry trends
  - Target market
  - Market competition
- Product/Service Analysis
  - Product line/service description
  - Proprietary nature
  - Competitive threats
- Marketing Strategy
  - Overall strategy
  - Pricing policy
  - Selling, distribution, servicing methods
- Management
  - Officers, organizational chart and responsibilities
  - Resumes of key personnel
  - Board of Directors/Advisors composition
- Financial Plan
  - Historical analysis
  - Budget projections
    - Income statement
    - Balance sheets
    - Cash flow
    - Capital expenditures
  - Explanation of projections
  - Key business ratios
  - Explanation of financing needs and anticipated use of funds

20 General Tips on Business Plan Preparation
Every business plan is a sales tool and it must look professional and read well to be effective. There are some general guidelines which every entrepreneur must follow to develop the overall form of their business plan:

1. Develop your business plan yourself, rather than hiring someone else to do it.
2. Keep the full plan as short as possible, focussing on key issues, not extraneous details.
3. Put yourself in the mind of the target investors.
4. Start with a short, compelling and concise one-page executive summary to attract immediate attention.
5. Get straight to the point!
6. Articulate concisely a simple but powerful plan for an innovative solution to an emerging but important consumer problem which is still unmet (Accel Partners, 1999).
7. Be specific about your market and your firm’s fit within the environment. Show that you really understand the target market.
8. Leave out technical jargon, use plain English.
9. Be clear in your key assumptions, using independent sources to back them up.
10. Be realistic in all your projections.
11. Openly address risks and problems, and how they can best be overcome. Any good investor will be able to identify these themselves and will not invest until they are addressed.
12. Demonstrate that you have a management team that has the experience and balance to make the venture a success.
13. Include milestone charts for past events within the firm, and those projected for the future.
14. Clearly discuss the firm’s financing needs, by addressing (Posner, 1993):
   - How much money you need, being very specific about the amount sought.
   - What you plan to use the money for.
   - How this money will improve the business.
   - How the business will pay the money back.
   - If Plan A does not work, what the backup plan is.
15. Prepare a time schedule for additional funds which will probably be needed.
16. Show that you fully understand the needs and interests of investors. The entrepreneur must learn to think in terms of the investors’ risks.
17. List possible exit strategies for investors.
18. Solicit comments and criticism from everyone you know.
20. Try not to let the process of fund raising adversely affect your firm’s on-going operations.

While we feel that these tips are some of the most important ones that an entrepreneur needs to follow in preparing a business plan, this list is clearly not exhaustive. In summary: try to write a short, concise, and thorough business plan which addresses a solution to an unmet need in a growing and potentially profitable market. Such a plan may sound more ideal than real, but then
investors (especially venture capitalists) have high standards which have to be met before their checkbook is put to good use.

### A Final & Amusing Reality Check on Business Plans

In his 1996 Harvard Business School case study, *Some Thoughts on Business Plans*, William Sahlman, one of the most respected academics in the entrepreneurship area, presents a unique reality check for some of the phrases we often see in business plans. Here is an excerpt:

*Translation Glossary for Business Plans*

<table>
<thead>
<tr>
<th>Business Plan Phrase</th>
<th>What It Really Means</th>
</tr>
</thead>
<tbody>
<tr>
<td>We conservatively project …</td>
<td>We read a book that said we had to have sales of $50 million in 5 years, and we reverse engineered the numbers …</td>
</tr>
<tr>
<td>We took our best guess and divided by 2 …</td>
<td>We accidentally divided by 5 …</td>
</tr>
<tr>
<td>We project a 10% margin …</td>
<td>We did not modify any of the assumptions in the business plan template we downloaded from the Internet …</td>
</tr>
<tr>
<td>The project is 98% complete …</td>
<td>To complete the remaining 2% will take as long as to create the initial 98%, but will cost twice as much …</td>
</tr>
<tr>
<td>We have a six month lead …</td>
<td>We have not tried to find out how many other people also have a six month lead …</td>
</tr>
<tr>
<td>We only need a 10% market share …</td>
<td>So too do all the other 50 entrants getting funded …</td>
</tr>
<tr>
<td>Customers are clamoring for our product …</td>
<td>We have not yet broached the issue of them paying for it. Also, all of our current customers are relatives …</td>
</tr>
<tr>
<td>We are the low cost producer …</td>
<td>We have not produced anything yet, but we are confident that we will be able to …</td>
</tr>
<tr>
<td>We have no competition</td>
<td>Only Microsoft, Netscape, IBM, and Sun have announced plans to enter the business …</td>
</tr>
<tr>
<td>Our management team has a great deal of experience</td>
<td>… consuming the product or service …</td>
</tr>
<tr>
<td>A select group of investors is considering the plan …</td>
<td>We mailed a copy of the plan to everyone in Pratt’s Guide to Venture Capital Sources …</td>
</tr>
<tr>
<td>We seek a value-added investor …</td>
<td>We are looking for a passive, dumb-as-rocks investor …</td>
</tr>
</tbody>
</table>
If you invest on our terms, you will earn a 68% IRR... If everything that could conceivably ever go right does go right, you might get your money back ...

Source: Sahlman (1996)