

## 5.4: Building a Plan

### Learning Objectives

1. Understand that before starting a business and before writing a formal plan, individuals should ask themselves some specific questions to see if they are ready for the challenges of small business ownership.
2. Understand that any solidly written plan will require information about the competitive environment. There are many publicly available sources of such information.
3. Understand that plans are future-oriented documents that require forecasts. Forecasting can be done through a variety of methods. Planners should be familiar with a variety of forecasting methods.
4. Understand that formal business plans should contain specific sections.
5. Know that scenario planning should help businesses prepare for low-probability events that might have a significant impact on the firm.
6. Know that there are many computer software packages that can assist in building a formal business plan.

Before talking about writing a formal business plan, someone interested in starting a business might want to think about doing some personal planning before drafting the business plan. Some of the questions that he or she might want to answer before drafting a full business plan are as follows:

- Why am I going into this business?
- What skills and resources do I possess that will help make the business a success?
- What passion do I bring to this business?
- What is my risk tolerance?
- Exactly how hard do I intend to work? How many hours per week?
- What impact will the business have on my family life?
- What do I really wish from this business?
  - Am I interested in financial independence?
  - What level of profits will be required to maintain my personal and/or family's lifestyle?
  - Am I interested in independence of action (no boss but myself)?
  - Am I interested in personal satisfaction?
- Will my family be working in this business?
- What other employees might I need? Melinda Emerson, "Life Plan before Business Plan," *Small Business Trends*, March 22, 2010, accessed October 10, 2011, [smallbiztrends.com/2010/03/life-plan-before-business-plan.html](http://smallbiztrends.com/2010/03/life-plan-before-business-plan.html).

Having addressed these questions, one will be in a much better position to craft a formal business plan.

### Video Clip 5.4.1:

*How to Write a Business Plan*



*Cartoon introduction to building a business plan.*

**Video Clip 5.4.2:**

*How to Write a Business Plan in 6 Minutes—Template*



*Voiceover PowerPoint video.*

**Video Clip 5.4.3:**

*How to Start a Business: How to Write a Business Plan*



A video from [Startupdaddy.com](http://Startupdaddy.com) that emphasizes the need for a business plan.

## Gathering Information

Building a solid business plan requires knowing the economic, market, and competitive environments. Such knowledge transcends “gut feelings” and is based on data and evidence. Fortunately, much of the required information is available through library resources, Internet sources, and government agencies and, for a fee, from commercial sources. Comprehensive business plans may draw from all these sources.

Public libraries and those at educational institutions provide a rich resource base that can be used at no cost. Some basic research sources that can be found at libraries are given in this section—*be aware that the reference numbers provided may differ from library to library.*

## Library Sources

### Background Sources

- Berinstein, Paula. *Business Statistics on the Web: Find Them Fast—At Little or No Cost* (Ref HF1016 .B47 2003).
- *The Core Business Web: A Guide to Information Resources* (Ref HD30.37 .C67 2003).
- Frumkin, Norman. *Guide to Economic Indicators*, 4th ed. (Ref HC103 .F9 2006). This book explains the meanings and uses of the economic indicators.
- Solie-Johnson, Kris. *How to Set Up Your Own Small Business*, 2 volumes (Ref HD62.7 .S85 2005). Published by the American Institute of Small Business.

### Company and Industry Sources

- *North American Industry Classification System, United States* (NAICS), 2007 (Ref HF1042 .N6 2007). The NAICS is a numeric industry classification system that replaced the Standard Industrial Classification (SIC) system. An electronic version is available from the [US Census Bureau](http://US Census Bureau).
- *Standard Industrial Classification Manual* (Ref HA40 .I6U63 1987). The industry classification system that preceded the NAICS.
- *Value Line Investment Survey* (Ref HG4751 .V18). Concise company and industry profiles are updated every thirteen weeks.

### Statistical Sources

- *Almanac of Business and Industrial Financial Ratios* (Ref HF5681 .R25A45 2010).
- *Business Statistics of the United States* (Ref HC101 .A13123 2009). This publication provides recent and historical information about the US economy.
- *Economic Indicators* (1971–present). The Council of Economic Advisers for the Joint Economic Committee of Congress publishes this monthly periodical; recent years are in electronic format only. Ten years of data are presented. Electronic versions are available in ABI/INFORM and ProQuest from September 1994 to present and Academic OneFile from October 1, 1991.
- *Industry Norms and Key Business Ratios* (Dun & Bradstreet; Ref HF5681 .R25I532 through Ref HF5681 .I572 [2000–2001 through 2008–2009]).

- *Rma Annual Statement Studies* (Ref HF5681 .B2R6 2009–2010). This publication provides annual financial data and ratios by industry.
- *Statistical Abstract of the United States* (Ref HA202 .S72 2010). This is the basic annual source for statistics collected by the government. Electronic version is available at [www.census.gov/compendia/statab](http://www.census.gov/compendia/statab).
- *Survey of Current Business* (1956–present). The Bureau of Economic Analysis publishes this monthly periodical; recent years are in electronic format only.

At some libraries, you may find access to the following resources online:

- Mergent Webreports. Mergent (formerly Moody's) corporate manuals are in digitized format. Beginning with the early 1900s, the reports include corporate history, business descriptions, and in-depth financial statements. The collection is searchable by company name, year, or manual type.
- ProQuest Direct is a database of general, trade, and scholarly periodicals, with many articles in full text. Many business journals and other resources are available.
- Standard and Poor's Netadvantage is a database that includes company and industry information.

## Internet Resources

In addition to government databases and other free sources, the Internet provides an unbelievably rich storehouse of information that can be incorporated into any business plan. It is not feasible to provide a truly comprehensive list of useful websites; this section provides a highly selective list of government sites and other sites that provide free information.

## Government Sites

- **[US Small Business Administration \(SBA\)](http://www.sba.gov)**. This is an excellent site to begin researching a business plan. It covers writing a plan, financing a start-up, selecting a location, managing employees, and insurance and legal issues. A follow-up page at <http://www.sba.gov> provides access to publications, statistics, video tutorials, podcasts, business forms, and chat rooms. Another page—<http://www.sba.gov/about-offices-list/2>—provides access to localized resources.
- **[SCORE Program](#)**. The SCORE program is a partner of the SBA. It provides a variety of services to small business owners, ranging from online (and in-person) mentoring, workshops, free computer templates, and advice on a wide range of small business issues.

In developing a business plan, it is necessary to anticipate the future economic environment. The government provides extensive statistics online.

- **[Consumer Price Index](#)**. This index provides information on the direction of prices for industries and geographic areas.
- **[Producer Price Index](#)**. Businesses that provide services or are focused on business-to-business (B2B) operations may find these data more appropriate for estimating future prices.
- **[National Wage Data](#)**. This site provides information on prevailing wages and can be broken down by occupation and location down to the metropolitan area.
- **[Consumer Expenditures Survey](#)**. This database provides information on expenditures and income. It allows for a remarkable level of refinement by occupation, age, or race.
- **[State and Local Personal Income and Employment](#)**. These databases provide a breakdown of personal income by state and metropolitan area.
- **[GDP by State and Metropolitan Region](#)**. This will provide an accurate guide to the overall economic health of a region or a city.
- **[US Census](#)**. This is a huge site with databases on population, income, foreign trade, economic indicators, and business ownership.

There are nongovernment websites, either free or charging a fee, that can provide assistance in building a business plan. A simple Google search for the phrase *small business plan* yields more than 67 million results. Various sites will either help with writing the plan, offer to write the plan for a fee, produce reports on industries, or assist small businesses by providing a variety of support services. The Internet offers a veritable cornucopia of information and support for those working on their business plans.

## Forecasting for the Plan

Prediction is very difficult, especially about the future.

Nils Bohr, Nobel Prize winner

Any business plan is a future-oriented document. Business plans are required to look between three and five years into the future. To produce them and accurately forecast sales, you will need estimates of expenses and other items, such as the required number of employees, interest rates, and general economic conditions. There are many different techniques and tools that can be used to forecast these items. The type of techniques used will be influenced by many factors, such as the following:

- **The size of the business.** Smaller businesses may have fewer resources to apply a wide variety of forecasting techniques.
- **The analytical sophistication of people who will be conducting the forecast.** The owner of a home business may have no prior experience with forecasting techniques.
- **The type of the organization.** A manufacturing concern that sells to a stable and relatively predictable environment that has been in existence for years might be able to employ a variety of standard statistical forecasting techniques; however, a small firm operating in a new or a chaotic environment might have to rely on significantly different techniques.
- **Historical records.** Does the firm have historical records for sales that can be used to project into the future?

There is no universal set of forecasting techniques that can be used for all types of small and midsize businesses. Forecasting can fall into a fairly comprehensive range of techniques with respect to level of sophistication. Some forecasting can be done on an intuitive basis (e.g., back-of-the-envelope calculations); others can be done with standard computer programs (e.g., Excel) or programs that are specifically dedicated to forecasting in a variety of environments.

A brief review of basic forecasting techniques shows that they can be divided into two broad classes: **qualitative forecasting methods** and **quantitative forecasting methods**. Actually, these terms can be somewhat misleading because qualitative forecasting methods do not imply that no numbers will be involved. The two techniques are separated by the following concept: qualitative forecasting methods assume that one either does not have historical data or that one cannot rely on past historical data. A start-up business has no past sales that can be used to project future sales. Likewise, if there is a significant change in the environment, one may feel uncomfortable using past data to project into the future. A restaurant operates in a small town that contains a large automobile factory. After the factory closes, the restaurant owner should anticipate that past sales will no longer be a useful guideline for projecting what sales might be in the next year or two because the owner has lost a number of customers who worked at the factory. Quantitative forecasting, on the other hand, consists of techniques and methods that assume you can use past data to make projections into the future.

Table 5.4.1: provides examples of both qualitative forecasting methods and quantitative forecasting methods for sales forecasting. Each method is described, and their strengths and weaknesses are given.

Table 5.4.1: Overview of Forecasting Methods

Technique	Description	Strength	Weakness
<b>Qualitative Sales Forecasting Methods</b>			
Simple extrapolation	This approach uses some data and simply makes a projection based on these data. The data might indicate that a particular section of town has many people walk through the section each day. Knowing that number, a store might make a simple estimate of what sales might be.	An extremely simple technique that requires only the most basic analytical capabilities.	Its success depends on the “correctness” of the assumptions and the ability to carry them over to reality. You might have the correct number of people passing your store, but that does not mean that they will buy anything.
Sales force	In firms with dedicated sales forces, you would ask them to estimate what future sales might be. These values would be pieced together with a forecast for next year.	The sales force should have the pulse of your customers and a solid idea of their intentions to buy. Its greatest strength is in the B2B environment.	Difficult to use in some business-to-customer (B2C) environments. Sales force members are compensated when they meet their quotas, but this might be an incentive to “low-ball” their estimates.

Technique	Description	Strength	Weakness
Expert opinion	Similar to sales force approach, this technique ask experts within the company to produce estimates of future sales. These experts may come from marketing, R&D, or top-level management.	Coalescing sales forecasts of experts should lead to better forecasts.	Teams can produce biased estimates and can be influenced by particular members of the team (i.e., the CEO).
Delphi	A panel of outside experts would be asked to estimate sales for a particular product or service. The results would be summarized in a report and given to the same panel of experts. They would then be asked to read their forecast. This might go through several iterations.	Best used for entirely new product service categories.	One has to be able to identify and recruit “experts” from outside the organization.
Historical analogy	With this technique, one finds a similar product’s or service’s past sales (life cycle) and extrapolates to your product or service. A new start-up has developed an innovative home entertainment product, but nothing like it has been seen in the market. You might examine past sales of CD players to get a sense of what future sales of the new product might be like.	One can acquire a sense of what factors might affect future sales. It is relatively easy and quick to develop.	One can select the wrong past industry to compare, and the future may not unfold in a similar manner.
Market research	The use of questionnaires and surveys to evaluate customer attitudes toward a product or a service.	One gains very useful insights into the stated desires and interests of consumers. Can be highly accurate in the short term.	Experienced individuals should do these. They can take time to conduct and are relatively expensive.
<b>Quantitative Sales Forecasting Methods</b>			
Trend analysis	This forecasting technique assumes that sales will follow some form of pattern. For example, sales are projected to increase at 15 percent a year for the next five years.	Extremely simple to calculate.	Sales seldom follow the same growth rate over any length of time.
Moving average	This technique takes recent class data for $N$ number of periods, adds them together, and divides by the number $N$ to produce a forecast.	Easy to calculate.	The basic use of this type of model fails to consider the existence of trends or seasonality in the data.

Technique	Description	Strength	Weakness
Seasonality analysis	Many products and services do not have uniform sales throughout the year. They exhibit seasonality. This technique attempts to identify the proportion of annual sales sold for any given time. The sales of swimming pool supplies in the Northeast, for example, would be much higher in the spring and summer than in the fall and winter.	Many products and services have seasonal demand patterns. By considering such patterns, forecasts can be improved.	Requires several years of past data and careful analysis. Useful for quarterly or monthly forecasts.
Exponential smoothing	This analytical technique attempts to correct forecasts by some proportion of the past forecast error.	Incorporates and weighs most recent data. Attempts to factor in recent fluctuations.	Several types of this model exist, and users must be familiar with their strengths and weaknesses. Requires extensive data, computer software, and a degree of expertise to use and interpret results.
Causal models—regression analysis	Causal models, of which there are many, attempt to identify why sales are increasing or decreasing. Regression is a specific statistical technique that relates the value of the dependent variable to one or more independent variables. The dependent variable sales might be affected by price and advertising expenditures, which are independent variables.	Can be used to forecast and examine the possible validity of relationships, such as the impact on sales by advertising or price.	Requires extensive data, computer software, and a high degree of expertise to use and interpret results.

Forecasting key items such as sales is crucial in developing a good business plan. However, forecasting is a very challenging activity. The further out the forecast, the less likely it will be accurate. Everyone recognizes this fact. Therefore, it is useful to draw on a variety of forecasting techniques to develop your final forecast for the business plan. To do that, you should have a fairly solid understanding of the strengths and weaknesses of the various approaches. There are many books, websites, and articles that could assist you in understanding these techniques and when they should or should not be used. In addition, one should be open to gathering additional information to assist in building a forecast. Some possible sources of such information would be associations, trade publications, and business groups. Regardless of what technique is used or the data source employed in building a forecast for business plan, one should be prepared to justify why you are employing these forecasting models.

#### Video Clip 5.4.4:

*Ask Tim Berry—How Do I Start a Sales Forecast?*



*Provides useful insights on how to start forecasting in the small business environment.*

**Video Clip 5.4.5:**

*Sales Forecast, Part 1: Structure*



*Tim Berry starts a discussion about using spreadsheets for forecasting.*

**Video Clip 5.4.6:**

*Sales Forecast, Part 2: Logic*





*This module discusses how to explain the logic behind a forecast.*

#### Video Clip 5.4.7:

*Sales Forecast, Part 3: Back to the Spreadsheet*



*This module continues by explaining how to use spreadsheets in forecasting.*

#### Web Resources for Forecasting

- **Three methods of sales forecasting** ([sbinfocanada.about.com/od/cashflowmgmt/a/salesforecast.htm](http://sbinfocanada.about.com/od/cashflowmgmt/a/salesforecast.htm)). This site provides three simplified approaches to sales forecasting.
- **Forecasting in business** ([www.enotes.com/business-finance-encyclopedia/forecasting-business](http://www.enotes.com/business-finance-encyclopedia/forecasting-business)). This is a relatively comprehensive overview of forecasting techniques in nontechnical terms.
- **Sales forecasting techniques** ([www.statisticalforecasting.com/sales-forecasting-techniques.php](http://www.statisticalforecasting.com/sales-forecasting-techniques.php)). This page provides insights into how to begin a sales forecast. It has excellent links to more advanced topics.
- **Time-critical decision making for business administration** ([home.ubalt.edu/ntsbarsh/stat-data/forecast.htm](http://home.ubalt.edu/ntsbarsh/stat-data/forecast.htm)). This site has an e-book format with several chapters devoted to analytical forecasting techniques.

## Building a Plan

Building your first business plan may seem extremely formidable. This may explain why there are so many software packages available to assist in this task. After building your first business plan, that steep learning curve should make subsequent plans for the business or other businesses significantly easier.

In preparing to build a business plan, there are some problem areas or mistakes that you should be on guard to avoid. Some may be technical in nature, while others relate to content issues. For the technical side, first and foremost, one should make sure that there are no misspellings or punctuation errors. The business plan should follow a logical structure. No ideal business plan clearly specifies the exact sections that need to be included nor is there an ideal length. Literature concerning business plans indicates that the appropriate length of the body of a business plan line should be between twenty and forty pages. This does not include appendixes that might provide critical data for the reader.

In developing a lengthy report, sometimes it is easy to fall into clichés or overused expressions. These should be avoided. Consider the visuals in the report. Data should be placed in either clearly mapped-out tables or well-designed graphs. The report should be as professional-looking as possible. Anticipate the audience that will be reading the report and write in a way that easily reaches them; avoid using too much jargon or technical terms.

The content in any business plan centers on two areas: realism and accuracy.

## Components of the Plan

There is no idealized structure for a business plan or a definitive number of sections that it must contain. The following subsections discuss the outline of a plan for a business start-up and identify some of the major sections that should be part of the plan.

### Cover Page

The cover page provides the reader with information about either the author of the plan or the person to contact concerning the business plan. It should contain all the pertinent information to enable the reader to contact the author, such as the name of the business, the business logo, and the contact person's address, telephone number, and e-mail address.

The table of contents enables the reader to find the major sections and components of the plan. It should identify the key sections and subsections and on which pages those sections begin. This enables the reader to turn to sections that might be of particular importance.

### Executive Summary

The **executive summary** is a section of critical importance and is perhaps the single most important section of the entire business plan. Quite often, it is the first section that a reader will turn to, and sometimes it may be the only section of the business plan that he or she will read. Chronologically, it should probably be the last section written. Jeffrey Timmons, Andrew Zachary, and Stephen Spinelli, *Business Plans That Work—A Guide for Small Business* (New York: McGraw-Hill, 2004), 113. The executive summary should provide an accurate overview of the entire document, which cannot be done until the whole document is prepared.

If the executive summary fails to adequately describe the idea behind the business or if it fails to do so in a captivating way, some readers may discard the entire business plan. As one author put it, the purpose of the executive summary is to convince the reader to “read on.” Carolyn Brown, “The Dos and Don’ts of Writing a Winning Business Plan,” *Black Enterprise*, April 1996, 114–122. The executive summary should contain the following pieces of information:

- What is the company's business?
- Who are its intended customers?
- What will be its legal structure?
- What has been its history (where one exists)?
- What type of funding will be requested?
- What is the amount of that funding?
- What are the capabilities of the key executives?

All this must be done in an interesting and captivating way. The great challenge is that executive summaries should be relatively short—between one and three pages. For many business people, this is the great challenge—being able to compress the required information in an engaging format that has significant size limitations.

## Business Section

**Goals.** These are broad statements about what you would like to achieve some point in the near future. Your goals might focus on your human resource policies (“We wish to have productive, happy employees”), on what you see as the source of your competitive advantage (“We will be best in service”), or on financial outcomes (“We will produce above-average return to our investors.”) Goals are useful, but they can mean anything to anyone. It is therefore necessary to translate the goals into objectives to bring about real meaning so that they can guide the organization. Ideally, objectives should be **SMART**—specific, measurable, achievable, realistic, and have a specific timeline for completion. Here is an example: one organizational goal may be a significant rise in sales and profits. When translating that goal into an objective, you might word the objectives as follows: a 15 percent increase in sales for the next three years followed by a 10 percent increase in sales for the following two years and a 12.5 percent increase in profits in each of the next five years. These objectives are quite specific and measurable. It is up to the decision-maker to determine if they are achievable and realistic. These objectives—sales and profits—clearly specify the time horizon. In developing the plan, owners are often very happy to develop goals because they are open to interpretation, but they will avoid objectives. Goals are sufficiently ambiguous, whereas objectives tie you to particular values that you will have to hit in the future. People may be concerned that they will be weighed on a scale and found wanting for failing to achieved their objectives. However, it is critical that your plan contains both goals and objectives. Objectives allow investors and your employees to clearly see where the firm intends to go. They produce targeted values to aim for and, therefore, are critical for the control of the firm’s operations.

**Vision and Mission Statements.** To many, there is some degree of confusion concerning the difference between a vision statement and a mission statement. **Vision statements** articulate the long-term purpose and idealized notion of what a business wishes to become. In the earliest days of Microsoft, when it was a small business, its version of a vision statement was as follows: “A computer on every desk and in every home.” In the early 1980s, this was truly a revolutionary concept. Yet it gave Microsoft’s employees a clear idea (vision) that to bring that vision into being, the software being developed would have to be very “user-friendly” in comparison to the software of that day. **Mission statements**, which are much more common in small business plans, articulate the fundamental nature of the business. This means identifying the type of business, how it will leverage its competencies, and possibly the values that drive the business. Put simply, a mission statement should address the following questions:

- Who are we? What business are we in?
- Who do we see as our customers?
- How do we provide value for those customers?

Sometimes vision and mission statements are singularly written for external audiences, such as investors or shareholders. They are not written for the audience for whom it would have the greatest meaning—the management team and the employees of the business. Unfortunately, many recognize that both statements can become exercises of stringing together a series of essentially meaningless phrases into something that appears to sound *right* or *professional*. You can find software on the web to automatically generate such vacuous and meaningless statements.

Sometimes a firm will write a mission statement that provides customers, investors, and employees with a clear sense of purpose of that company. Zappos has the following as its mission statement: “Our goal is to position Zappos as an online service leader. If we can get customers to associate Zappos as the absolute best in service, then we can expand beyond shoes.” “Inc. 500 Mission Statements,” *MissionStatements.com*, accessed October 10, 2011, [www.missionstatements.com/inc\\_500\\_mission\\_statements.html](http://www.missionstatements.com/inc_500_mission_statements.html). The mission statement of Ben & Jerry’s Ice Cream focuses both on defining their product and their values: “To make, distribute and sell the finest quality all-natural ice cream and euphoric concoctions with a continued commitment to incorporating wholesome, natural ingredients and promoting business practices that respect the Earth and the Environment.” “Mission Statement,” *Ben & Jerry’s*, accessed October 10, 2011, [www.benjerry.com/activism/mission-statement](http://www.benjerry.com/activism/mission-statement).

**Keys to Success.** This section identifies those specific elements of your firm that you believe will ensure success. It is important for you to be able to define the competencies that you intend to leverage to ensure success. What makes your product or service unique? What specific set of capabilities do you bring to the competitive scene? These might include the makeup of and the experience of your management team; your operational capabilities (e.g., unique skills in design, manufacturing, or delivery); your marketing skillsets; your financial capabilities (e.g., the ability to control costs); or the personnel that make up the company.

## Industry Review

In this section, you want to provide a fairly comprehensive overview of the industry. A thorough understanding of the industry that you will be operating in is essential to understand the possible returns that your company will earn within that industry. Investors

want to know if they will recover their initial investment. When will they see a profit? Remember, investors often carefully track industries and are well aware of the strengths and limitations within a particular industry. Investors are looking for industries that can demonstrate growth. They also want to see if the industry is structurally attractive. This might entail conducting Porter's five forces analysis; however, this is not required in all cases. If there appear to be some issues or problems with industry level growth, then you might want to be able to identify some segments of the industry where growth is viable.

## Products or Services

This section should be an in-depth discussion of what you are offering to customers. It should provide a complete and clear statement of the products or the services that you are offering. It should also discuss the core competencies of your business. You should highlight what is unique, such as a novel product or service concept or the possession of patents. You need to show how your product or service specifically meets particular market needs. You must identify how the product or the service will satisfy specific customers' needs. If you are dealing with a new product or service, you need to demonstrate what previously unidentified needs it will meet and how it will do so. At its birth, Amazon had to demonstrate that an online bookstore would be preferable to the standard bookstore by offering the customer a much wider selection of books than would be available at an on-site location.

This section could include a discussion of technical issues. If the business is based on a technological innovation—such as a new type of software or an invention—then it is necessary to provide an adequate discussion of the specific nature of the technology. One should take care to always remember the audience for whom you are writing the plan. Do not make this portion too technical in nature. This section also might discuss the future direction of the product or service—namely, where will you be taking (changing) the product or the service after the end of the current planning horizon? This may require a discussion of future investment requirements or the required time to develop new products and services. This section may also include a discussion of pricing the product or the service, although a more detailed discussion of the issue of pricing might be found in the marketing plan section. If you plan to include the issue of pricing here, you should discuss how the pricing of the product or the service was determined. The more detailed you are in this description, the more realistic it will appear to the readers of the business plan. You may wish to discuss relationships that you have with vendors that might have an impact on reducing cost and therefore an impact on price. It is important to discuss how your pricing scheme will compare with competitors. Will it be higher than average or below the average price? How does the pricing fit in with the overall strategy of the firm?

This section must have a high degree of honesty. Investors will know much about the industry and its limitations. You need to identify any areas that might be possible sources of problems, such as government regulations, issues with new product development, securing distribution channels, and informing the market of your existence. Further, it is important to identify the current competitors in the industry and possible future competitors.

## Marketing Plan

An introductory marketing course always introduces the four Ps: product, price, place, and promotion. The marketing section of the business plan might provide more in-depth coverage of how the product or the service better meets customer value than that of competitors. It should identify your target customers and include coverage of who your competitors are and what they provide. The comparison between your firm and its competitors should highlight differences and point to why you are providing superior value. Pricing issues, if not covered in the previous section, could be discussed or discussed in more detail.

The issue of location, particularly in retail, should be covered in detail. Perhaps one of the most important elements of the marketing plan section is to specify how you intend to attract customers, inform them of the benefits of using your product or service, and retain customers. Initially, customers are attracted through advertising. This section should delineate the advertising plan. What media will be used—flyers, newspapers, magazines, radio, television, web presence, direct marketing, and/or social media campaigns? This section should cover any promotional campaigns that might be used.

## The Management Team

Physical resources are not the only determinant of business success. The human resources available to a firm will play a critical role in determining its success. Readers of your business plan and potential investors should have a clear sense of the management team that will be running a business. They should know the team with respect to the team's knowledge of the business, their experience and capabilities, and their drive to succeed. Arthur Rock, a venture capitalist, was once quoted as saying, "I invest in people, not the idea." "Invest in People, Not Ideas," *Michael Karnjanaprakorn*, January 15, 2009, accessed October 10, 2011, [www.mikekarnj.com/blog/2009/01/15/invest-in-people-not-ideas](http://www.mikekarnj.com/blog/2009/01/15/invest-in-people-not-ideas).

This section of the business plan has several elements. It should contain an organizational chart that will delineate the responsibilities and the chain of command for the business. It should specify who will occupy each major position of the business. You might want to explain who is doing what job and why. For every member of the management team, you should have a complete résumé. This should include educational background (both formal and informal) and past work experience, including the jobs they have held, responsibilities, and accomplishments. You might want to include some other biographical data such as age, although that is not required.

If you plan to use specific advisers or consultants, you should mention the names and backgrounds of these people in this section of the plan. You should also specify why these people are being used.

An additional element of your discussion of the management team will be the intended compensation schemes. You should specify the intended salaries for the management team while also including issues of their benefits and bonuses or any stock position that they may take in the company. This section should also identify any gaps in the management team and how you intend to fill these positions.

Depending on the nature of the business, you might wish to include in this section the personnel (employees) that will be required. You should identify the number of people that are currently working for the firm or that will have to be hired; you should also identify the skills that they need to possess. Further discussion should include the pay that will be provided: whether they will be paid a flat salary or paid hourly, if and when you intend to use overtime, and what benefits you intend to provide. In addition, you should discuss any training requirements or training programs that you will have to implement.

## Financial Statements

The financial statements section of the business plan should be broken down into three key subsections: the income statement, the balance sheet, and the cash-flow statement. Before proceeding with these sections, we discuss the assumptions used to build these sections. The opening section of the financial statements section should also include, in summary format, projections of sales, the sales growth rate, key expenses and their growth rates, net income across the forecasting horizon, and assets and liabilities. Amir M Hormozi, Gail S. Sutton, Robert D. McMinn, Wendy Lucio, "Business Plans for New or Small Businesses: Paving the Path to Success," *Management Decision* 40, no. 8 (2002): 755.

As previously discussed, bankers—and to lesser extent venture capitalists—will be primarily concerned with this section of the business plan. It is vital that this section—whether you are an existing business seeking more funding or a start-up—have realistic financial projections. The business plan should contain clear statements of the underlying assumptions that were used to make these financial projections. The clearer the statements and the more realistic the assumptions behind these statements, then the greater the confidence the reader will have in these projections. Few businesspeople have a thorough understanding of these financial statements; therefore, it is advisable that someone with an accounting or a financial background review these statements before they are included in the report. We will have a much more in-depth discussion of these statements in [Accounting and Cash Flow](#).

The future planning horizon for financial projections is normally between three and five years. The duration that you will use will depend on the amount of capital that the business is seeking to raise, the type of industry the business is in, and the forecasting issues associated with making projections. Also, the detail required in these financial statements will be directly tied to the type and size of the business.

## Income Statement

The **income statement** examines the overall profitability of a firm over a particular period of time. As such, it is also known as a profit-and-loss statement. It identifies all sources of revenues generated and expenses incurred by the business. For the business plan, one should generate annual plans for the first three to five years. Some suggest that the planner develop more "granulated" income statements for the first two years. By granulated, we mean that the first year income statement should be broken down on a monthly basis, while the second year should be broken down on a quarterly basis.

Some of the key terms (they will be reviewed in much greater detail in ["Financial Management"](#) found in the income statement are as follows:

- **Income.** All revenues and additional incomes produced by the business during the designated period.
- **Cost of goods sold.** Costs associated with producing products, such as raw materials and costs associated directly with production.
- **Gross profit margin.** Income minus the cost of goods sold.

- **Operating expenses.** Costs in doing business, such as expenses associated with selling the product or the service, plus general administration expenses.
- **Depreciation.** This is a special form of expense that may be included in operating expenses. Long-term assets—those whose useful life is longer than one year—decline in value over time. Depreciation takes this fact into consideration. There are several ways in which this declining value can be determined. It is a noncash expenditure expense.
- **Total expenses.** The cost of goods sold plus operating expenses and depreciation.
- **Net profit before interest and taxes.** This is the gross profit minus operating expenses; another way of stating net profit is income minus total expenses.
- **Interest.** The required payment on all debt for the period.
- **Taxes.** Federal, state, and local tax payments for the firm.
- **Net profit.** This is the net profit after interest and taxes. This is the term that many will look at to determine the potential success of business operations.

## Balance Sheet

The **balance sheet** examines the assets and liabilities and owner's equity of the business at some particular point in time. It is divided into two sections—the credit component (the assets of the business) and the debit component (liabilities and equity). These two components must equal each other. The business plan should have annual balance sheet for the three- or five-year planning horizon. The elements of the credit component are as follows:

- **Current assets.** These are the assets that will be held for less than one year, including cash, marketable securities, accounts receivable, notes receivable, inventory, and prepaid expenses.
- **Fixed assets.** These assets are not going to be turned into cash within the next year; these include plants, equipment, and land. It may also include intangible assets, such as patents, franchises, copyrights, and goodwill.
- **Total assets.** This is the sum of current assets and fixed assets.

Liabilities consist of the following:

- **Current liabilities.** These are debts that are to be paid within the year, such as lines of credit, accounts payable, other items payable (including taxes, wages, and rents), short-term loans, dividends payable, and current portion of long-term debt.
- **Long-term liabilities.** These are debts payable over a period greater than one year, such as notes payable, long-term debt, pension fund liability, and long-term lease obligations.
- **Total liabilities.** This is the sum of current liabilities and long-term liabilities.
- **Owner's equity.** This represents the value of the shareholders' ownership in the business. It is sometimes referred to as net worth. It may be composed of items such as preferred stock, common stock, and retained earnings.

## Cash-Flow Statement

From a practical and survival standpoint, the **cash-flow statement** may be the most important component of the financial statements. The cash-flow statement maps out where cash is flowing into the firm and where it flows out. It recognizes that there may be a significant difference between profits and cash flow. It will indicate if a business can generate enough cash to continue operations, whether it has sufficient cash for new investments, and whether it can pay its obligations. Businesspeople soon realize that profits are nice, but cash is king.

Cash flows can be divided into three areas of analysis: cash flow from operations, cash flow from investing, and cash flow from financing. Cash flow from operations examines the cash inflows from revenues and interest and dividends from investments held by the business. It then identifies the cash outflows for paying suppliers, employees, taxes, and other expenses. Cash flow from investing examines the impact of selling or acquiring current and fixed assets. Cash flow from financing examines the impact on the cash position from the changes in the number of shares and changes in the short- and long-term debt position of the firm. Given the critical importance of cash flow to the survival of the small business, it will be covered in much more detail in "[Financial Management](#)".

## Additional Information

Depending on the nature of the business and the amount of funding that is being sought, the plan might include more materials. For an existing business, you may wish to include past tax statements and/or personal financial statements. If the business is a franchise, you should include all legal contracts and documents. The same should be done for any leasing, licensing, or rent



agreements. This section should be seen as a catchall incorporating any materials that would support the plan. One does not want to be in the position of being asked by readers of the plan—"Where are these documents?"

## Appendixes

The financial section of the business plan should include summaries of the three key financial elements. The details behind the financial statements should be included as an appendix along with clear statements concerning the assumptions that were used to build them. The appendixes may also include different scenarios that were considered in building the plan, such as alternative market growth assumptions or alternative competitive environments. Demonstrating that the author(s) considered "what-if" situations tells potential investors that the business is prepared to handle changing conditions. It should include items such as logos, diagrams, ads, and organizational charts.

## Developing Scenarios

Change is constant.

Benjamin Disraeli

Business plans are analyses of the future; they can err on the side of either optimistic projections or conservative projections. From the standpoint of the potential investor, it is always better to err on the side of conservatism. Regardless of either bias, business plans are generally built on the basis of expected futures and past experience. Unfortunately, the future does not always emerge in a clearly predicated manner. One can have a dramatic change that can have significant impact on the business. Often such changes occur in the external environment and are beyond the control of the business management team. These external changes can occur within the technical environment; it can be based on changes in customer needs, changes with respect to the suppliers, changes in the economic environment—at the local, national, or global level. Dramatic change can also occur within the organization itself—the death of the owner or members of the management team. "Workshops and Events," *SCORE*, accessed October 10, 2011, [www.score.org/events/workshops](http://www.score.org/events/workshops).

One way for an organization to deal with significant changes is a process known as **scenario planning**. The real origins of scenario planning can be traced back to the early nineteenth century activity known as *Kriegsspiel*—war gaming—a system for training officers developed by the Prussian command. This process of looking at future wars was adopted by many militaries in the later nineteenth century. In the 1950s, a more formal format was used at the RAND Institute for examining possible future changes in the military and geopolitical environments. The early 1980s saw it applied to industrial settings. Royal Dutch Shell examined the question of what would happen if there were a significant drop in the price of oil. This was after two oil crises that pushed the price of oil up significantly. The notion that oil prices would drop was considered to be an extremely unlikely event, but it did occur. Royal Dutch Shell was one of the few oil companies that did not suffer because its scenario analyses enabled them to be ready to deal with that situation. P. McNamee, *Tools and Techniques for Strategic Management* (New York: Pergamon Press, 1985), 187.

What could be the possible use of scenario planning for small businesses? There are several areas in which small businesses should apply scenario planning to be better prepared for future disruptions.

## Identify Significant Changes That Might Impact the Business

*Consider major shifts in the customer's notion of value.* As mentioned in "[Your Business Idea: The Quest for Value](#)", the firm should always be examining what constitutes value in the eyes of the consumer and how that might shift. Henry Ford's model T car was a global success because customers initially valued a reliable vehicle at a low price. Ford Motor Company continued to meet the customer's notion of value by constantly driving down the unit cost. However, by the mid-1920s, customers' notion of value included not only price but also issues such as styling and improved technologies. General Motors was able to recognize that there were changes in the customer's value notion and provided them with a range of vehicles. Ford failed to recognize that change and suffered a significant drop in sales.

*Shifts in the economic environment.* The recent recession clearly indicates that economies can suffer significant shifts in a short period of time. These shifts can have dramatic impact on all business operations. Small-business owners have seen significant tightening of bank credit and changes with respect to the requirements for using credit cards. One could easily imagine the critical importance for small businesses to consider the impacts that would follow significant changes in interest rates. Southwest Airlines, in anticipation of possible fluctuations in oil prices, used futures contracts to deal with dramatic shifts in the price of oil. When oil prices rose significantly, they were in a much better position than their competitors.

*The entrance of new competitors.* Small businesses should always be ready to consider the impact of facing new competitors and new types of competition. Consider the case of small local retail outlets when a Walmart superstore opens in the area.

## Consideration of Disasters

The best way to deal with any potential disaster is not while it is occurring or after it has happened but before it occurs. Small businesses should anticipate what they will do in the case of physical disasters, such as fire, earthquakes, or floods. Other disasters might involve the bankruptcy or loss of a major supplier or a major customer. A restaurant or a food market should have a contingency plan in the case of a power failure that might lead to food spoilage. Such a business might also want to conduct a scenario planning exercise to see what its responses would be in the case of a customer complaining of food poisoning. Other disaster scenarios that should be considered by small businesses include the impact and ramifications of having the computer system crash; having the service for the website crash; or having the website hacked, with the possible loss of customer information.

## New Opportunities

Almost all businesses, large and small, must be prepared to seize new opportunities. This may mean that they have to consider the impact of technological change on the business or how technology can offer them new business opportunities. The technology of stereo lithography, a process by which three-dimensional objects are built layer by layer, has been available for more than a decade. Bespoke Innovations saw the potential for using this technology. Bespoke Innovations can develop, in a short period of time, custom artificial legs for a price of \$5,000–\$6,000 and with features that are not found in \$60,000 prostheses. Ashlee Vance, “A Technology Sets Inventors Free to Dream,” *New York Times*, September 14, 2010.

Scenario planning should be a periodic exercise, but it should be conducted no more than once a year. The actual frequency might be dependent on the perceived rate of change for the industry or the presence of storm clouds on the horizon. Scenario planning has several distinct activities, which may be as follows:

- **Pick one area that might occur in the future that would have significant impact on the business.** What if the national joblessness rate remains at over 9 percent for the next three to five years? What if a major customer decides to buy from a competitor or that customer is in financial trouble? What if there are changes in the national defense budget? A luncheonette in New London, Connecticut, where Electric Boat builds nuclear submarines, wants to consider the impact of changes in the defense budget. A decrease in the budget for building nuclear submarines would reduce the number of subs made in New London, which might lead to layoffs at Electric Boat and fewer customers for the luncheonette.
- **Identify factors that might impact that issue.** This sometimes is referred to as a PEST analysis, where the P stands for political issues, E stands for economic issues, S stands for sociocultural issues, and T stands for technology issues. Each factor would be analyzed to see how it might impact the scenario. In our previous luncheonette example, the restaurant might want to consider an upcoming election to see how each party would support defense appropriations, and it might look at the overall economy to determine whether a downturn in the economy might lead to a cut in defense appropriations. It is unlikely that sociocultural issues would impact defense appropriations. Technology issues, whether a breakthrough in some design by the United States or by some other country, might determine the number and location of submarines built in the United States.
- **Rank the relative importance of the previous factors.** Not all factors under consideration can be considered equally important. It is critical in a scenario planning exercise to see which factors are most important so that decision makers can focus on the ramifications of those factors in the analysis.
- **Develop scenarios.** Having identified the relative importance of the factors, the next stage would be to develop a limited number of possible scenarios (no more than two or three). Each scenario would map out possible outcomes for each key factor. Based on these values, the group conducting the scenario planning exercise would develop insights into this possible future world.
- **How do the scenarios impact your business?** For each future scenario, the team should examine how that possible future state would impact the operation of the business. Continuing with the luncheonette example, the owner might see that a particular political party would be elected in the next election and the economy will still be in the doldrums. Together, this might indicate a cut in the naval building budget. This will translate into a reduced number of submarines built in New London and a reduction in employment at Electric Boat. The luncheonette’s sales will obviously drop off. Now the owner must consider what it might do in that situation.

Scenario planning offers the opportunity for small business owners to examine the future on a long-term basis. It should force them to look at external environments and conditions that can have a dramatic impact on the survival of their firm. It broadens their



thinking and creates an environment of increased flexibility. It enables a business to respond to those sudden shocks that might destroy other firms.

## Computer Aids

Business plans can be built using a combination of word-processing and spreadsheet programs by those who are adept at using them. However, the entire process of constructing a comprehensive business plan can be greatly simplified by using a dedicated business plan software package. These packages are designed to produce reports that have all the required sections for a business plan, they greatly facilitate the creation of the financial statements with charts, and they often allow for the inclusion of materials from other programs. Most of them are fairly reasonably priced from \$50 to \$150.

There are many such packages on the market, and they range from those designed for novices to those that can generate annual plans by easily incorporating data from external sources, such as the accounting programs of a business. When evaluating competing programs, there are some primary and secondary factors that should be considered. “2012 Business Plan Software Product Comparisons,” *TopTenReviews.com*, accessed October 10, 2011, [business-plan-software-review.toptenreviews.com](http://business-plan-software-review.toptenreviews.com). The primary factors are as follows:

- **Ease of building the report.** The various sections of the report should be clearly identified, and the authors should be able to work on each section independent of their sequence within the report. Text and data entry should be simple and allow for easy corrections or revisions.
- **Financial statements.** The software should facilitate building the income statement, the balance sheet, and the cash-flow statement. For multiyear projections, the software should support the forecasting process.
- **Import from other programs.** The software should be able to incorporate data from a variety of programs, such as Word and Excel. Ideally, it should be able to import data from a variety of accounting programs.
- **Support services.** The software company should bundle a variety of support services, including clear instructions, tutorials, and access to Internet or call-number support. Many packages provide sample business plans for different industries.

The secondary factors are as follows:

- **Access to research support.** Some software packages include access to business publications and databases to aid with market research.
- **Export options.** These packages allow for the report or parts of the report to be exported to different formats—Word, Excel, PowerPoint, HTML, or PDF.
- **Ancillary analysis tools.** Some packages either directly include or offer additional programs for market planning, budgeting, or valuation.

The following is a partial listing of companies that have business planning software:

- **Small Business Point.** This company offers business planning software and the opportunity for them to build your plan for you.
- **Business Plan Pro.** This company provides business planning software with sample plans for a wide number of industries plus options for acquiring industry data at national, state, or local levels. The company also has programs for marketing planning and legal issues advice.
- **Business Plan Software.** This company offers a number of products, including business planning software, a strategic planning program, financial projection and cash-flow forecasting programs, and marketing planning software.
- **JIAN Biz Plan.** This company’s products include business planning programs, software for human resources, marketing planning programs, and contract development software.
- **PlanWrite.** In addition to offering programs for business, strategic, and marketing planning, this company has products that provide advice in the area of sales strategy and pricing.
- **Plan Magic.** This company offers a suite of planning products ranging from particular industries to financial and marketing planning software.

## KEY TAKEAWAYS

- The business planning for a start-up business should consider if the owner(s) is/are ready to accept the challenges of operating a business.
- Comprehensive business plans will require information about the industry, competitors, and customers. Owners or the writers of the business plan should be aware of where they can obtain this information.

- Forecasting is critical to the success of any business. There are many different approaches to forecasting: some are simple extrapolations of trends, while others can be computationally complex. The business should use a forecasting system that is not only accurate but also makes the users feel comfortable.
- Although business plans come in different “sizes and shapes,” they should have some key sections: executive summary, mission statement, industry analysis, marketing plan, description of the management team, and financial projections.
- Some businesses should make it a practice of conducting scenario analyses. This is a process of examining possible future events and what should be the response of the business.
- The complexity and difficulty of building a comprehensive business plan can be significantly reduced by using one of the available business-planning software packages.

## EXERCISES

1. In Exercise 2 of "[Developing our Strategy](#)", you were asked to interview five local business owners. In addition to asking them questions about strategy, please ask them the following questions: (a) How do they forecast their sales? (b) Inventory? (c) Economic conditions? (d) Have they ever conducted anything like a scenario analysis or formally considered what they would do if an emergency struck—fire, flood, death of a business partner, and so forth?
2. Go to the Appendix ("[Appendix: A Sample Business Plan](#)"), which contains Robert Rainsford's business plan. (You will be asked to examine portions of this report throughout the text to evaluate different sections.)
  1. Read his executive summary and critique it. How would you improve it?
  2. Evaluate the document's vision and mission statements. Are there any major problems? How would you improve them?
  3. Evaluate the industry analysis section of the report. What additional data could be used in this section of the report? Where would you suggest that Robert go to get the data?
3. Imagine that you are going to start a business and that you want a great looking plan. Evaluate three of the business plan software packages. Based on your evaluation, write a report that describes their strengths and weaknesses. Which would you select and why?

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