

The Entrepreneur's Guide to Financial Maturity ®
Reduce Your Cost of Capital – Write a Business Plan

Starting a business is relatively easy, keeping it solvent isn't!

The above statement is borne out by the harsh economic realities that more than 80% of start-ups fail within the first 5 years of operation. Educated, highly skilled people started many of those failed businesses. So why do most businesses fail? The primary reasons are poor management and insufficient capitalization.

The single worst decision an entrepreneur can make is not having a comprehensive business plan that is:

- Well thought out and logical
- Clear and concise
- Identifies business opportunities
- Identifies potential pitfalls and competition
- Provides for adequate reserves for contingencies
- Illustrates management's ability to make the business a success
- Shows profitability

Drafting a business plan, at a minimum, can be overwhelming, stressful, time consuming and a challenging process. Unfortunately, many business owners treat the process as a “necessary evil” to obtaining financing, not an opportunity for the management team to acquire a better understanding of the business or developing a “game plan” for operating the business.

Many entrepreneurs establish their priorities based upon urgency. Developing a business plan and providing longer-term financial stability for the business

often is deemed to be a lower short-term priority. Entrepreneurs frequently are too busy working in the business, not on the business. Entrepreneurs generally do not allocate an appropriate amount of time to work on growing the business, or seeking out new opportunities consistent with the business plan. It is the planning that will take the business to its next level. While entrepreneurs generally agree that the concept of business planning has merit, the percentage of small to mid-sized businesses that implement the business planning process is small.

Most business plans are written in order to obtain financing. As a result, management often uses shortcuts so that the “documentation” does not hold up the frantic search for capital. Many entrepreneurs fail to recognize that it is the lack of planning that contributes to the frantic search for capital and the ensuing cash crunches. Cash crunches increase the cost of capital.

Other reasons for writing a business plan include:

- To define and fix goals and objectives.
- To develop tactics to achieve those objectives
- To create regular business review and take appropriate corrective action, if necessary
- To define and evaluate a new product line, promotions, or business expansion
- To verify and establish commonality of interests between partners, key members of management

Assume the following hypothetical situation:

Each member of Company A’s management team views their business and its prospects totally differently. As a result, management takes inconsistent actions. They lack cohesiveness and in one way, shape or form it is being communicated to its employees, suppliers, customers and stakeholders of Company A. How confident are those stakeholders that Company A will:

- *Remain a reliable source of business?*
- *Be a company you should be extending credit to?*
- *Be the type of business those suppliers, customers and others want to do business with for the long-term?*

- *Remain in business in the long run?*

The lack of confidence in management can have serious implications, including:

- *Higher employee turnover*
- *Difficulty replacing employees with top tier employees*
- *Potential loss of customers*
- *Loss of suppliers or suppliers cutting back on available credit*
- *Financial institutions looking to reduce its exposure by cutting back on available credit or requiring more restrictive terms*

Without clear focus and direction, common goals (including operating and financial goals), as well as a detailed understanding of what it takes to operate, finance, market and grow a business, it will be difficult for Company A to succeed.

If we further assume that Company A's management team does not understand its cost structure, its breakeven points or the impact of an incremental dollar of sales or lost sales to its cash flow, it would be difficult for Company A to succeed in business.

If we further assume that Company A's management team does not understand the following, how effective will any marketing campaign be?

- *Who its customers are*
- *Why its customer purchase or do not purchase its products or service*
- *What compelling reason would a potential customer have to change existing habits and purchase Company A's goods or services*

Without a through knowledge of these and other factors it would be difficult for Company A to succeed in business and its failure is almost certain.

If Company A's management were to develop the business plan and establish benchmarks, management would be in a better position to evaluate and take corrective actions, when necessary. Planning and benchmarking will help management operate the business effectively. The added benefits of drafting the business plan include helping management:

- Build the management team's confidence and when establishing credibility with investors, bankers, suppliers, customers and within the its own industry
- Establishes management's goal and expectations
- Builds the management's confidence in its ability to deliver what is expected of each team member
- Make people accountable for achieving goals and objectives
- Prepare for funding requests well in advance of when it is necessary
- Prepare for the due diligence process
- Addresses issues such as the purpose of the financing, how the funding source will be repaid.

The plan would show how much business must be generated to cover operating expenses and make a satisfactory return on the capital invested. Components of the business plan should include:

- Executive Summary – A summary of the plan that sells managements' ideas in three pages or less
- Company Summary – A factual description of the company, its ownership and history
- Products, Services or both – A description of the company's products and/or services and how it stands out from competitive products and services
- Market Analysis – A summary of the company's typical customers, competitive landscape, market size, and expected market growth
- Strategy and Implementation – A description of how the company will sell its products, how management will put its plan into action, and benchmarks
- Management Summary – A summary of the management team's background, their experiences and key accomplishments
- Financial Plan – Contains key financial information including projected sales, operating expenses, capital requirements, cash flow, and profits and losses, return on investment

When management is focused on achieving its clear goals and objectives, and is totally committed to take whatever actions are necessary (provided the actions are legal) to achieve those objectives, management significantly increases the company's likelihood of success.

Financial institutions look at a company's management team and assess management's ability and commitment to deliver what is projected. Management's presentation, focus, proven track record, overall knowledge of the operations and processes, understanding of industry trends and the business model including underlying assumptions, realistic projections, are factors looked at for determining probability of success. Each investor determines whether or not the particular financing request meets its underwriting guidelines or risk tolerance levels. If management understands the investor's guidelines and risk tolerance, management will not spend valuable time chasing financing sources that are not likely to fund their request, potentially avoiding cash crunches.

Most investors want to see the following in addition to the business plan:

- Successful experience or proven track record
- Integrity and honesty
- Dedication, commitment, passion, energy to the business
- A vision and ability to communicate it
- Knowledge, skill level and intelligence
- Leadership ability

The entrepreneur that cannot satisfy the above is indirectly communicating to an investor that the business is high risk. Generally, the higher the perceived investment risk, the higher the entrepreneur's cost of money. Accordingly, when a company:

- Uses the knowledge gained from the business plan to operate the business
- Consistently meets or exceeding its performance targets
- Has a multi year operating history showing good performance
- Thoroughly understands its customers, operations, its marketing plan, capital expenditures needs to achieve its goals

That company provides a different comfort level to a lender or investor than when the entrepreneur that says my business will work "cause it has to," or "I never failed at anything in my life, I'm not about to start now." Unfortunately, those or similar "compelling reasons" are given too frequently.

Many traditional investors are not in the business of training the companies they lend to, or invest in. Those investors that provide such an “education” do it for a price. Therefore, when management:

- Does not understand how to operate the business effectively
- Makes too many bad critical decisions
- Fails to achieve goals and benchmarks
- Fails to take appropriate corrective actions to meet targets

These shortcomings make that business is more difficult to fund. When a business’ “infrastructure” is not in place, second, third or fourth tier investors may finance those enterprises, and that often comes at a high cost of capital.

Sitting down and looking at a blank computer screen can be overwhelming. Even beginning with business plan software the task is difficult, at best. A professional consultant will facilitate the process of writing the plan. However, a seasoned professional will require:

- Your team’s active participation in the process
- To think through your business concepts
- To understand the underlying concepts in your business idea
- Understand the underlying assumptions in the financial projections
- Understand the interrelationships between the numbers and its impact on profitability

You should expect to work closely with the consultant to ensure that he or she develops a good plan that accurately represents management’s vision. The knowledge gained from the business planning process should significantly strengthen the company’s balance sheet and profitability. In other words, developing and using the knowledge gained from developing the business plan enables the entrepreneur to accelerate the growth of the business at a lower cost of money.

Financial Maturity® is a registered trademark owned by Morris Bocian. Copyright © 2003, 2004 and 2005 Creative Business Planning Incorporated. All rights reserved. All information is from sources deemed reliable. Such information has not been verified and no express representations are made nor implied as to the accuracy thereof, and it is submitted subject to errors and omissions, and is subject to change or withdrawal without notice.