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Chapter 5

The Business Plan

Consolidated Industries' Hammer Forge



Source: Used with permission from Consolidated Industries.

Consolidated Industries represents one of the thousands of small manufacturers that exist throughout the United States. It has been in business for more than sixty years, specializing in the forging of ferrous, nonferrous, and exotic materials. Its prime customer base has been the aerospace industry, but it has also expanded into other industrial customers.

Originally a family business, Consolidated Industries was sold to new owners in 1999. Once the owner reached retirement age, his children, a brother and sister, found it difficult to agree on the future direction of the company. This period of confusion was made more difficult when the head of sales died. Competitors exploited this situation. The new CEO—John Wilbur—immediately recognized that there had been some complacency about generating new customers, and the firm would not be able to survive in the long run merely on its backlog of orders. Wilbur began to aggressively deal with the firm's problems and build its customer base. In ten years, he was able to take Consolidated Industries' sales from \$8 million a year to \$30 million a year. He attributes much of this success to the firm's commitment to business planning.

Soon after taking over the business, he started a comprehensive planning process. Given the pressing issues the firm was facing, the first plan had a one-year horizon. It was instrumental in gaining the support of Consolidated Industries' bankers, which carried it through those difficult years. In the intervening years, the plan's horizon was expanded to five years. Although Wilbur admitted that the projections may be "pipe dreams" after the first two years, he said it was important to maintain the five-year horizon to force the business to think about the future. The main goals of the plan had been to examine ways to lower costs and expand the customer base, particularly outside the aerospace industry.

The plan would be constantly evolving; detailed metrics would provide guidance to the various units throughout the firm. These metrics were broken down on a quarterly basis and were color coded to allow the various units to see how well they were progressing toward the achievement of the goals and the objectives. It had a detailed sales plan that emphasized developing new customers in new industries. To this end, it significantly focused on developing new products. In the past few years, the number of new products increased from six per year to seventy-seven per year. This meant an enlargement of the engineering staff, but it also meant a much closer relationship with customers. Wilbur estimated that 50 percent of the new products were a codesign with customers. The planning process also enabled the business to incorporate technology in new ways. The firm used videoconferencing to communicate with both customers and sister units. Another important element of the plan was the concept of succession planning. As vital as the planning process was, Wilbur said that “it is all about people. Any plan to improve the firm has to bring people into the process and bring them together.”

5.1 Developing Your Strategy

LEARNING OBJECTIVES

1. Understand the term *strategy* and why it is important for small business.
2. Define the four generic strategies identified by Porter.
3. Evaluate the ramifications of each generic strategy for the operations of a small business.

Without a strategy, the organization is like a ship without a rudder, going around in circles.

- Joel Ross and Michael Kami

As mentioned in [Chapter 2 "Your Business Idea: The Quest for Value"](#), it is critically important for any business organization to be able to accurately understand and identify what constitutes customer value. To do this, one must have a clear idea of who your customers are or will be. However, simply identifying customer value is insufficient. An organization must be able to provide customer value within several important constraints. One of these constraints deals with the competition—what offerings are available and at what price. Also, what additional services might a company provide? A second critically important constraint is the availability of resources to the business organization. Resources consist of factors such as money, facilities, equipment, operational capability, and personnel.

Here is an example: a restaurant identified its prime customer base as being upscale clientele in the business section of a major city. The restaurant recognized that it has numerous competitors that are interested in providing the same clientele with an upscale dining experience. Our example restaurant might provide a five-course, five-star gourmet meal to its customers. It also provides superlative service. If a comparable restaurant failed to provide a comparable meal than the example restaurant, the example restaurant would have a competitive advantage. If the example restaurant offered these sumptuous meals for a relatively low price in comparison to its competitors, it would initially seem to have even more of an advantage. However, if the price charged is significantly less than the cost of providing the meal, the service in this situation could not be maintained. In fact, the restaurant inevitably would have to go out of business. Providing excellent customer service may be a necessary condition for business survival but, in and of itself, it is not a sufficient condition.

So how does one go about balancing the need to provide customer value within the resources available while always maintaining a watchful eye on competitors' actions? We are going to argue that what is required for that firm is to have a **strategy**¹.

The word *strategy* is derived from the Greek word *strategos*, which roughly translates into the art of the general, namely a military leader. Generals are responsible for marshaling required resources and organizing the troops and the basic plan of attack. Much in the same way, executives as owners of businesses are expected to have a general idea of the desired outcomes, acquire resources, hire and train personnel, and generate plans to achieve those outcomes. In this sense, all businesses, large and small, have strategies, whether they are clearly written out in formal business plans or reside in the mind of the owner of the business.

There are many different formal definitions of strategy with respect to business. The following is a partial listing of some of the definitions given by key experts in the field:

A strategy is a pattern of objectives, purposes or goals and the major policies and plans for achieving these goals, stated in such a way as to define what business the company is in or is to be in and the kind of company it is or to be. Kenneth Arrow, *The Concept of Corporate Strategy* (Homewood, IL: Irwin, 1971), 28.

- Kenneth Arrow

The determination of the long-run goals and objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals. Alfred Chandler, *Strategy and Structure* (Cambridge, MA: MIT Press, 1962), 13.

- Alfred Chandler

What business strategy is all about, in a word, is competitive advantage. Kenichi Ohmae, *The Mind of the Strategist* (Harmondsworth, UK: Penguin Books, 1983), 6.

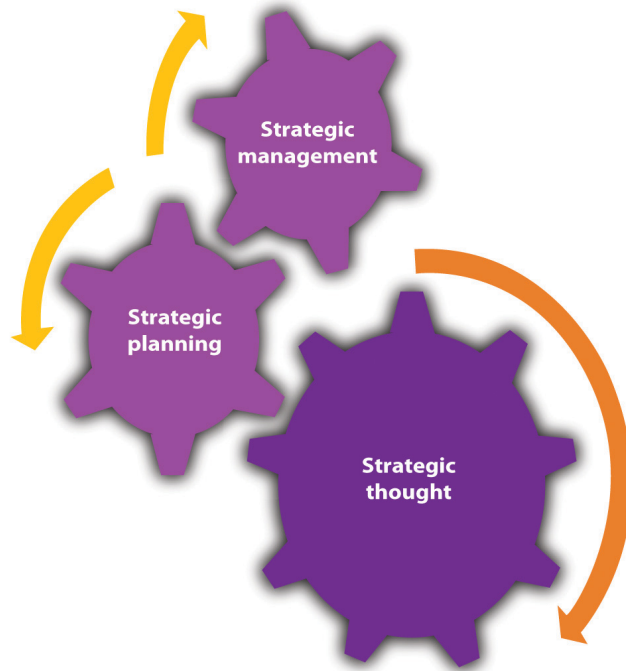
- Kenichi Ohmae

1. The path by which a firm seeks to provide its customers with value, given the competitive environment and within the constraints of the resources available to the firm.

We define the strategy of a business as follows: *A firm's strategy is the path by which it seeks to provide its customers with value, given the competitive environment and within the constraints of the resources available to the firm.*

Whatever definition of strategy is used, it is often difficult to separate it from two other terms: strategic planning and strategic management. Both terms are often perceived as being in the domain of large corporations, not necessarily small to midsize businesses. This is somewhat understandable. The origin of strategic planning as a separate discipline occurred over fifty years ago. It was mainly concerned with assisting huge multidivisional or global businesses in coordinating their activities. In the intervening half-century, strategic planning has produced a vast quantity of literature. Mintzberg, Lampel, Ahlstrand, in a highly critical review of the field, identified ten separate schools associated with strategic planning. Henry Mintzberg, Joseph Lampel, and Bruce Ahlstrand, *Strategic Safari: A Guided Tour through the Wilds of Strategic Management* (New York: Free Press, 1998). With that number of different schools, it is clear that the discipline has not arrived at a common consensus. Strategic planning has been seen as a series of techniques and tools that would enable organizations to achieve their specified goals and objectives. Strategic management was seen as the organizational mechanisms by which you would implement the strategic plan. Some of the models and approaches associated with strategic planning and strategic management became quite complex and would prove to be fairly cumbersome to implement in all but the largest businesses. Further, strategic planning often became a bureaucratic exercise where people filled out forms, attended meetings, and went through the motions to produce a document known as the strategic plan. Sometimes what is missed in this discussion was a key element—strategic thinking. Strategic thinking is the creative analysis of the competitive landscape and a deep understanding of customer value. It should be the driver (see [Figure 5.1 "Strategy Troika"](#)) of the entire process. This concept is often forgotten in large bureaucratic organizations.

Figure 5.1 *Strategy Troika*



Strategic thinkers often break commonly understood principles to reach their goals. This is most clearly seen among military leaders, such as Alexander the Great or Hannibal. Robert E. Lee often violated basic military principles, such as dividing his forces. General Douglas MacArthur shocked the North Koreans with his bold landings behind enemy lines at Inchon. This mental flexibility also exists in great business leaders.

Solomon and Friedman recounted a prime example of true strategic thinking. Paul Solman and Thomas Friedman, *Life and Death on the Corporate Battlefield: How Companies Win, Lose, Survive* (New York: Simon and Schuster, 1982), 24–27. Wilson Harrell took a small, closely held, cleaning spray company known as Formula 409 to the point of having national distribution. In 1967, the position that Formula 409 held was threatened by the possible entry of Procter & Gamble into the same spray cleaning market. Procter & Gamble was a huge consumer products producer, noted for its marketing savvy. Procter & Gamble began a program of extensive market research to promote its comparable product they called Cinch. Clearly, the larger firm had a much greater advantage. Harrell knew that Procter & Gamble would perform test market research. He decided to do the unexpected. Rather than directly confront this much larger competitor, he began a program where he reduced advertising expenditures in Denver and stopped promoting his Formula 409. The outcome was that Procter & Gamble had spectacular results, and the

company was extremely excited with the potential for Cinch. Procter & Gamble immediately begin a national sales campaign. However, before the company could begin, Harrell introduced a promotion of his own. He took the Formula 409 sixteen-ounce bottle and attached it to a half-gallon size bottle. He then sold both at a significant discount. This quantity of spray cleaner would last the average consumer six to nine months. The market for Procter & Gamble's Cinch was significantly reduced. Procter & Gamble was confused and confounded by its poor showing after the phenomenal showing in Denver. Confused and uncertain, the company chose to withdraw Cinch from the market. Wilson Harrell's display of brilliant strategic thinking had bested them. He leveraged his small company's creative thinking and flexibility against the tremendous resources of an international giant. Through superior strategic thinking, Harrell was able to best Procter & Gamble.

Video Clip 5.1

What Is Strategy?

[\(click to see video\)](#)

Michael Porter of Harvard Business School provides a brief discussion of what strategy is.

Video Clip 5.2

Strategic Thinking and the Definition of Strategy

[\(click to see video\)](#)

A Center for Management Organization and Effectiveness (CMOE) discussion of strategy; it leads to other similar videos.

Video Clip 5.3

Strategic Thinking—Develop Strategic Thinking Skills to Give Yourself a Competitive Edge

[\(click to see video\)](#)

Follow-up CMOE video on strategic thinking.

Video Clip 5.4

Strategic Thinking and Management for Competitive Advantage

[\(click to see video\)](#)

Two Wharton professors discuss how strategic thinking is critical to the acquisition of competitive advantage.

Video Clip 5.5

Mastering Strategic Thinking Workshop

[\(click to see video\)](#)

A professor discusses the importance of strategic thinking for leadership.

Video Clip 5.6

From Strategic Thinking to Planning

[\(click to see video\)](#)

A speaker illustrates that successful plans are tied to strategic thinking.

Do You Have a Strategy and What Is It?

We have argued that all businesses have strategies, whether they are explicitly articulated or not. Perry stated that “small business leaders seem to recognize that the ability to formulate and implement an effective strategy has a major influence on the survival and success of small business.” Stephen C. Perry, “A Comparison of Failed and Non-Failed Small Businesses in the United States: Do Men and Women Use Different Planning and Decision Making Strategies?,” *Journal of Developmental Entrepreneurship* 7, no. 4 (2002): 415.

The extent to which a strategy should be articulated in a formal manner, such as part of a business plan, is highly dependent on the type of business. One might not expect a formally drafted strategy statement for a nonemployee business funded singularly by the owner. One researcher found that formal plans are rare in businesses with fewer than five employees. Stephen C. Perry, “An Exploratory Study of U.S. Business Failures and the Influence of Relevant Experience and Planning,” (PhD diss., George Washington University, 1998; dissertation available through UMI Dissertation Services, Ann Arbor, MI), 42. However, you should clearly have that expectation for any other type of small or midsize business.

Any business with employees should have an articulated strategy that can be conveyed to them so that they might better assist in implementing it. Curtis pointed out that in the absence of such communication, “employees make pragmatic short-term decisions that cumulatively form an ad-hoc strategy.” David A. Curtis, *Strategic Planning for Smaller Businesses: Improving Corporate Performance and Personal Reward* (Cambridge, MA: Lexington Books, 1983), 29. These ad hoc (realized) strategies may be at odds with the planned (intended) strategies to guide a firm. Henry Mintzberg, *The Rise and Fall of Strategic Planning* (New York: Free Press, 1994), 46. However, any business that seeks external funding from bankers, venture capitalists, or “angels” must be able to specify its strategy in a formal business plan.

Clearly specifying your strategy should be seen as an end in itself. Requiring a company to specify its strategy forces that company to think about its core issues, such as the following:

- Who are your customers?
- How are you going to provide value to those customers?
- Who are your current and future competitors?
- What are your resources?
- How are you going to use these resources?

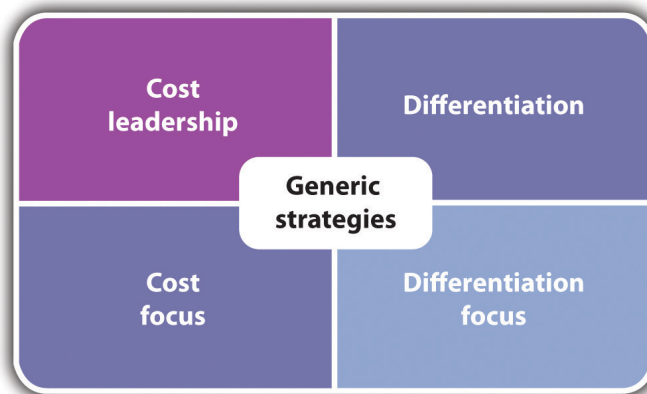
One commentator in a blog put it fairly well, “It never ceases to amaze me how many people will use GPS or Google maps for a trip somewhere but when it comes to starting a business they think that they can do it without any strategy, or without any guiding road-map.” Harry Tucci, comment posted to the following blog: Rieva Lesonsky, “A Small Business Plan Doubles Your Chances for Success, Says a New Survey,” *Small Business Trends*, June 20, 2010, accessed October 10, 2011, smallbiztrends.com/2010/06/business-plan-success-twice-as-likely.html.

Types of Strategies

In 1980, Michael Porter a professor at Harvard Business School published a major work in the field of strategic analysis—*Competitive Strategy*. Michael Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (New York: Free Press, 1980), 21. To simplify Porter’s thesis, while competition is beneficial to customers, it is not always beneficial to those who are competing. Competition may involve lowering prices, increasing research and development (R&D), and increasing advertising and other expenses and activities—all of which can lower profit margins. Porter suggested that firms should carefully examine the industry in which they are operating and apply what he calls the five forces model. These five forces are as follows: the power of suppliers, the power of buyers, the threat of substitution, the threat of new entrants, and rivalry within the industry. We do not

need to cover these five forces in any great detail, other than to say that once the analysis has been conducted, a firm should look for ways to minimize the dysfunctional consequences of competition. Porter identified four generic strategies that firms may choose to implement to achieve that end. Actually, he initially identified three generic strategies, but one of them can be bifurcated. These four strategies are as follows (see [Figure 5.2 "Generic Strategies"](#)): cost leadership, differentiation, cost focus, and differentiation focus. These four generic strategies can be applied to small businesses. We will examine each strategy and then discuss what is required to successfully implement them.

Figure 5.2 *Generic Strategies*



Low-Cost Advantage

A **cost leadership**² strategy requires that a firm be in the position of being the lowest cost producer in its competitive environment. By being the lowest cost producer, a firm has several strategic options open to it. It can sell its product or service at a lower price than its competitors. If price is a major driver of customer value, then the firm with the lowest price should sell more. The low-cost producer also has the option of selling its products or services at prices that are comparable to its competitors. However, this would mean that the firm would have a much higher margin than its competitors.

Obviously, following a cost leadership strategy dictates that the business be good at curtailing costs. Perhaps the clearest example of a firm that employs a cost leadership strategy is Walmart. Walmart’s investment in customer relations and inventory control systems plus its huge size enables it to secure the “best” deals from suppliers and drastically reduce costs. It might appear that cost leadership strategies are most suitable for large firms that can exploit economies of scale. This is not necessarily true. Smaller firms can compete on the basis of cost leadership.

2. A firm is in the position of being the lowest cost producer in its competitive environment.

They can position themselves in low-cost areas, and they can exploit their lower overhead costs. Family businesses can use family members as employees, or they can use a web presence to market and sell their goods and services. A small family-run luncheonette that purchases used equipment and offers a limited menu of standard breakfast and lunch items while not offering dinner might be good example of a small business that has opted for a cost leadership strategy.

Differentiation

A **differentiation**³ strategy involves providing products or services that meet customer value in some unique way. This uniqueness may be derived in several ways. A firm may try to build a particular brand image that differentiates itself from its competitors. Many clothing lines, such as Tommy Hilfiger, opt for this approach. Other firms will try to differentiate themselves on the basis of the services that they provide. Dominoes began to distinguish itself from other pizza firms by emphasizing the speed of its delivery. Differentiation also can be achieved by offering a unique design or features in the product or the service. Apple products are known for their user-friendly design features. A firm may wish to differentiate itself on the basis of the quality of its product or service. Kogi barbecue trucks operating in Los Angeles represent such an approach. They offer high-quality food from mobile food trucks. “Kogi Truck Schedule,” *Kogi BBQ*, accessed October 10, 2011, kogibbq.com. They further facilitate their differentiation by having their truck routes available on their website and on their Twitter account.

Adopting a differentiation strategy requires significantly different capabilities than those that were outlined for cost leadership. Firms that employ a differentiation strategy must have a complete understanding of what constitutes customer value. Further, they must be able to rapidly respond to changing customer needs. Often, a differentiation strategy involves offering these products and services at a premium price. A differentiation strategy may accept lower sales volumes because a firm is charging higher prices and obtaining higher profit margins. A danger in this approach is that customers may no longer place a premium value on the unique features or quality of the product or the service. This leaves the firm that offers a differentiation strategy open to competition from those that adopt a cost leadership strategy.

3. A firm provides products or services that meet customer value in some unique way.
4. A firm seeks to provide value through low cost for a *subset* of the market given the competitive environment and within the constraints of the resources available to the firm.
5. A firm concentrates on providing a unique product or service to a segment of the market.

Focus—Low Cost or Differentiation

Porter identifies the third strategy—focus. He said that focus strategies can be segmented into a **cost focus**⁴ and a **differentiation focus**⁵.

In a focus strategy, a firm concentrates on one or more segments of the overall market. Focus can also be described as a niche strategy. Focus strategy entails deciding to some extent that we do not want to have everyone as a customer. There are several ways that a firm can adopt a focus perspective:

- **Product line.** A firm limits its product line to specific items of only one or more product types. California Cart Builder produces only catering trucks and mobile kitchens.
- **Customer.** A firm concentrates on serving the needs of a particular type of customer. Weight Watchers concentrates on customers who wish to control their weight or lose weight.
- **Geographic area.** Many small firms, out of necessity, will limit themselves to a particular geographic region. Microbrewers generally serve a limited geographic region.
- **Particular distribution channel.** Firms may wish to limit themselves with respect to the means by which they sell their products and services. Amazon began and remains a firm that sells only through the Internet.

Firms adopting focus strategies look for distinct groups that may have been overlooked by their competitors. This group needs to be of sufficiently sustainable size to make it an economically defensible option. One might open a specialty restaurant in a particular geographic location—a small town. However, if the demand is not sufficiently large for this particular type of food, then the restaurant will probably fail. Companies that lack the resources to compete on either a national level or an industry-wide level may adopt focus strategies. Focus strategies enable firms to marshal their limited resources to best serve their customers.

As previously stated, focus strategies can be bifurcated into two directions—cost focus or differentiation focus. IKEA sells low-priced furniture to those customers who are willing to assemble the furniture. It cuts its costs by using a warehouse rather than showroom format and not providing home delivery. Michael Dell began his business out of his college dormitory. He took orders from fellow students and custom-built computers to their specifications. This was a cost focus strategy. By building to order, it almost totally eliminated the need for any incoming, work-in-process, or finished goods inventories.

A focus differentiation strategy concentrates on providing a unique product or service to a segment of the market. This strategy may be best represented by many specialty retail outlets. The Body Shop focuses on customers who want natural ingredients in their makeup. Max and Mina is a kosher specialty ice cream store in New York City. It provides a constantly rotating menu of more than 300 exotic

flavors, such as Cajun, beer, lox, corn, and pizza. The store has been written up in the *New York Times* and *People* magazine. Given its odd flavors, Max and Mina’s was voted the number one ice cream parlor in America in 2004. *Max and Mina’s Ice Cream*, accessed October 10, 2011, www.maxandminasicecream.com.

Evaluating Strategies

The selection of a generic strategy by a firm should not be seen as something to be done on a whim. Once a strategy is selected, all aspects of the business must be tied to implementing that strategy. As Porter stated, “Effectively implementing any of these generic strategies usually requires total commitment and supporting organizational arrangements.” Michael Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (New York: Free Press, 1980), 21. The successful implementation of any generic strategy requires that a firm possess particular skills and resources. Further, it must impose particular requirements on its organization (see [Table 5.1 "Summary of Generic Strategies"](#)).

Even successful generic strategies must recognize that market and economic conditions change along with the needs of consumers. Henry Ford used a cost leadership strategy and was wildly successful until General Motors began to provide different types of automobiles to different customer segments. Likewise, those who follow a differentiation strategy must be cautious that customers may forgo “extras” in a downturn economy in favor of lower costs. This requires businesses to be vigilant, particularly with respect to customer value.

Table 5.1 Summary of Generic Strategies

Generic Strategy	Required Activities	Issues
Cost leadership	<ul style="list-style-type: none"> • Economies of scale • Reduce overhead costs • Lower cost of supplies • Capital investment in technology to reduce cost 	<ul style="list-style-type: none"> • Product or service becomes a commodity with no brand loyalty • Changing technology cuts your cost advantage • New entrants can produce at even

Generic Strategy	Required Activities	Issues
	<ul style="list-style-type: none"> • Labor cost reduction through supervision, outsourcing, and work design • Low-cost distribution • Reduce cost of manufacturing or providing service • Tight financial control • Operate in lower cost environments • Production-based incentives 	<p>lower costs (e.g., China)</p> <ul style="list-style-type: none"> • Focus on cost reduction means that you miss changing customer tastes
Differentiation	<ul style="list-style-type: none"> • Unique or highly improved products or services • Brand image • Creative approach to marketing • Reputation for quality and product or service innovation 	<ul style="list-style-type: none"> • Qualitative difference between you and low-cost producer may not be enough to sustain sales • Differentiating factor may no longer be attractive to customers • Imitation narrows perceived differences

Generic Strategy	Required Activities	Issues
	<ul style="list-style-type: none"> • Ability to attract creative personnel • Effective coordination among R&D, marketing, and operations 	
Focus—low cost	<ul style="list-style-type: none"> • Reduce overhead costs • Lower cost of supplies • Labor cost reduction through supervision, outsourcing, and work design • Low-cost distribution • Tight financial control • Operate in lower cost environments • Production-based incentives 	<ul style="list-style-type: none"> • Cost advantage of focused firms is lost with respect to broader competitors • Differentiation advantage with a focused market is lost • Competitors find even smaller markets to focus on
Focus—differentiation		

Generic Strategy	Required Activities	Issues
	<ul style="list-style-type: none"> • Unique or highly improved products or services • Creative approach to marketing • Reputation for quality and product/service innovation • Ability to attract creative personnel • Effective coordination among R&D, marketing, and operations 	<ul style="list-style-type: none"> • Cost advantage of focused firms is lost with respect to broader competitors • Differentiation advantage with a focused market is lost • Competitors find even smaller markets to focus on

Video Clip 5.7

Porter's Strategies—Generic Strategies

[\(click to see video\)](#)

Examples of generic strategies.

Video Clip 5.8

The Five Competitive Forces That Shape Strategy

[\(click to see video\)](#)

A long interview with Michael Porter discussing the five forces model.

KEY TAKEAWAYS

- Any firm, regardless of size, needs to know how it will compete; this is the firm's strategy.
- Strategy identifies how a firm will provide value to its customers within its operational constraints.
- Strategy can be reduced to four major approaches—cost leadership, differentiation, cost focus, and differentiation focus.
- Once a given strategy is selected, all of a firm's operations should be geared to implementing that strategy.
- No strategy will be successful forever and therefore needs to be constantly evaluated.

EXERCISES

1. As previously noted, Walmart competes on the basis of cost leadership. Show how a variety of local firms could successfully compete with Walmart by the correct selection of one of the generic strategies.
2. Identify five local businesses and talk to their owners. Ask them if they have a formal strategy. If they say no, ask how they compete. Try to determine if they have a strategy in place even if they cannot articulate one. (Look at Exercise 1 in [Section 5.2 "The Necessity for a Business Plan"](#) for some additional questions that you might want to ask these owners.)

5.2 The Necessity for a Business Plan

LEARNING OBJECTIVES

1. Understand that the probability of running a successful business is significantly increased with a formal business plan.
2. Understand that although many small business owners express reasons for not planning, they do themselves a great disservice by not having a formal plan.
3. Understand that businesses that seek to secure external funding must produce a formal plan.

An intelligent plan is the first step to success. The man who plans knows where he is going, knows what progress he is making and has a pretty good idea of when he will arrive. Planning is the open road to your destination. If you don't know where you're going, how can you expect to get there?

- Basil Walsh

In Chapter 1 "Foundations for Small Business", we discussed the issue of failure and small businesses. Although research on small business failure has identified many factors, one reason that always appears at the top of any list is the failure to plan. Interestingly, some people argue that planning is not essential for a start-up business, but they are in a distinct minority. Jason Cohen, "Don't Write a Business Plan," *Building43*, January 27, 2010, accessed October 10, 2011, www.building43.com/blogs/2010/01/27/dont-write-a-business-plan. The overwhelming consensus is that a well-developed plan is essential for the survival of any small (or large) business. T. C. Carbone, "Four Common Management Failures and How to Avoid Them," *Management World* 10, no. 8 (1981): 38. Patricia Schaeffer, "The Seven Pitfalls of Business Failure and How to Avoid Them," *Business Know-How*, 2011, accessed October 10, 2011, www.businessknowhow.com/startup/business-failure.htm. Isabel M. Isodoro, "10 Rules for Small Business Success," *PowerHomeBiz.com*, 2011, www.powerhomebiz.com/vol19/rules.htm. Rubik Atamian and Neal R. VanZante, "Continuing Education: A Vital Ingredient of the 'Success Plan' for Small Business," *Journal of Business and Economic Research* 8, no. 3 (2010): 37. Perry found that firms with more than five people benefit from having a well-developed business plan. Stephen C. Perry, "A Comparison of Failed and Non-Failed Small Businesses in the United States: Do Men and Women Use Different Planning and Decision Making Strategies?," *Journal of Developmental Entrepreneurship* 7, no. 4 (2002): 415.

A recent study found that there was a near doubling of successful growth for those businesses that completed business plans compared to those that did not create one. It must be pointed out that this study might be viewed as being biased because the founder of the software company whose main product is a program that builds business plans conducted the study. However, the results were examined by academics from the University of Oregon who validated the overall results. They found that “except in a small number of cases, business planning appeared to be positively correlated with business success as measured by our variables. While our analysis cannot say the completing of a business plan will lead to success, it does indicate that the type of entrepreneur who completes a business plan is also more likely to produce a successful business.” Rieva Lesonsky, “A Small Business Plan Doubles Your Chances for Success, Says a New Survey,” *Small Business Trends*, June 20, 2010, accessed October 10, 2011, smallbiztrends.com/2010/06/business-plan-success-twice-as-likely.html.

Basically, there are two main reasons for developing a comprehensive business plan: (1) a plan will be extraordinarily useful in ensuring the successful operation of your business; and (2) if one is seeking to secure external funds from banks, venture capitalists, or other investors, it is essential that you be able to demonstrate to them that they will be recovering their money and making a profit. Let us examine each reason in detail.

Many small business owners operate under a mistaken belief that the only time that they need to create a business plan is at the birth of the company or when they are attempting to raise additional capital from external sources. They fail to realize that a business plan can be an important element in ensuring day-to-day success.

The initial planning process aids the operational success of a small business by allowing the owner a chance to review, in detail, the viability of the business idea. It forces one to rigorously consider some key questions:

- Is the business strategy feasible?
- What are the chances it will make money?
- Do I have the operational requirements for starting and running a successful business?
- Have I considered a well-thought-out marketing plan that clearly identifies who my customers will be?
- Do I clearly understand what value I will provide to these customers?
- What will be the means of distribution to provide the product or the service to my customers?
- Have I clarified to myself the financial issues associated with starting and operating the business?

- Do I have to reexamine these notions to ensure success?

Possessing an actual written plan enables you to have people outside the organization evaluate your business plan. Using friends, colleagues, partners, or even consultants may provide you with an unbiased evaluation of the assumptions.

It is not enough to create an initial business plan; you should anticipate making the planning process an annual activity. The Prussian military theorist von Moltke once argued that no military plan survives the first engagement with the enemy. Likewise, no company evolves in the same way as outlined in its initial business plan.

Overcoming the Reluctance to Formally Plan

By failing to prepare, you will prepare them to fail.

- Benjamin Franklin

Unfortunately, it appears that many small businesses do not make any effort to build even an initial business plan, let alone maintain a planning process as an ongoing operation, even though there is clear evidence that the failure to plan may have serious consequences for the future success of such firms. This unwillingness to plan may be understandable in nonemployee businesses, but it is inexcusable as a business grows in size. Why, therefore, do some businesses fail to begin the planning process?

- **We do not need to plan.** One of the prime reasons individuals fail to produce a business plan is that they believe that they do not have to plan. This may be attributable to the size of the firm; nonemployee firms that have no intention of seeking outside financing might sincerely believe that they have no need for a formal business plan. Others may believe that they so well understand the business and/or industry that they can survive and prosper without the *burdensome* process of a business plan. The author of *Business Plan for Dummies*, Paul Tiffany, once argued that if one feels lucky enough to operate a business successfully without resorting to a business plan, then he or she should forget about starting a business and head straight to Las Vegas.
- **I am too busy to plan.** Anyone who has ever run a business on his or her own can understand this argument. The day-to-day demands of operating a business may make it seem that there is insufficient time

to engage in any ancillary activity or prepare a business plan.

Individuals who accept this argument often fail to recognize that the seemingly endless buzz of activities, such as constantly putting out fires, may be the direct result of not having thought about the future and planned for it in the first place.

- **Plans do not produce results.** Small-business owners (entrepreneurs) are action- and results-oriented individuals. They want to see a tangible outcome for their efforts, and preferably they would like to see the results as soon as possible. The idea of sitting down and producing a large document based on assumptions that may not play out exactly as predicted is viewed as a futile exercise. However, those with broader experience understand that there will be no external funding for growth or the initial creation of the business without the existence of a well-thought-out plan. Although plans may not yield the specified results contained within them, the process of thinking about the plan and building it often yield results that the owner might not initially appreciate.
- **We are not familiar with the process of formal planning.** This argument might initially appear to have more validity than the others. Developing a comprehensive business plan is a daunting task. It might seem difficult if not impossible for someone with no experience with the concept. Several studies have indicated that small business owners are more likely to engage in the planning process if they have had prior experience with planning models in their prior work experience. H. Hodges and T. Kent, "Impact of Planning and Control Sophistication in Small Business," *Journal of Small Business Strategy* 17, no. 2 (2006-7): 75. Fortunately, this situation has changed rather significantly in the last decade. As we will illustrate in [Section 5.3 "Building a Plan"](#), there are numerous tools that provide significant support for the development of business plans. We will see that software packages greatly facilitate the building of any business plan, including marketing plans and financial plans for small businesses. We also show that the Internet can provide an unbelievably rich source of data and information to assist in the building of these plans.

Although one could understand the reticence of someone new to small business (or in some cases even seasoned entrepreneurs), their arguments fall short with respect to the benefits that will be derived from conducting a structured and comprehensive business planning process.

Plans for Raising Capital

Every business plan should be written with a particular audience in mind. The annual business plan should be written with a management team and for the employees who have to implement the plan. However, one of the prime reasons for writing a business plan is to secure investment funds for the firm. Of course, funding the business could be done by an individual using his or her own personal wealth, personal loans, or extending credit cards. Individuals also can seek investments from family and friends. The focus here will be on three other possible sources of capital—banks, venture capitalists, and angel investors. It is important to understand what they look for in a business plan. Remember that these three groups are investors, so they will be anticipating, at the very least, the ability to recover their initial investment if not earn a significant return.

Bankers

Bankers, like all businesspeople, are interested in earning a profit; they want to see a return on their investment. However, unlike other investors, bankers are under a legal obligation to ensure that the borrower pledge some form of collateral to secure the loan. Tim Berry, “What Bankers Look for in a Business Plan...and What You Should Expect When Taking Your Business Plan to a Bank,” *AllBusiness.com*, November 7, 2006, accessed October 10, 2011, www.allbusiness.com/business-planning-structures/business-plans/3878953-1.html. This often means that banks are unwilling to fund a start-up business unless the owner is willing to pledge some form of collateral, such as a second mortgage on his or her home. Many first-time business owners are not in a position to do that; securing money from a bank occurs most frequently for an existing business that is looking to expand or for covering a short-term cash-flow need. Banks may lend to small business owners who are opening a second business provided that they can prove a record of success and profitability.

Banks will require a business plan. It should be understood that bank loan officers will initially focus on the financial components of that client, namely, the income statement, balance sheet, and the cash-flow statement. The bank will examine your projections with respect to known industry standards. Therefore, the business plan should not project a 75 percent profit margin when the industry standard is 15 percent, unless the author of the plan can clearly document why he or she will be earning such a high return.

Some businesses may raise funds with the assistance of a Small Business Administration (SBA) loan. These loans are always arranged through a commercial bank. With these loans, the SBA will pledge up to 70 percent of the total value of the loan. This means that the owner still must provide, at the very least, 30 percent of

the total collateral. The ability to secure one of these loans is clearly tied to the adequacy of the business plan.

Venture Capitalists

Another possible source of funding is **venture capitalists**⁶. The first thing that one should realize about venture capitalists is that they are not in it just to make a profit; they want to make returns that are substantially above those to be found in the market. For some, this translates into the ability to secure five to ten times their initial investment and recapture their investment in a relatively short period of time—often less than five years. It has been reported that some venture capitalists are looking for returns in the order of twenty-five times their original investment. Marc Mays, “Small Business Venture Capital Strategies,” *eZine Articles*, 2010, accessed October 10, 2011, [ezinearticles.com/?Small-Business-Venture-Capital-Strategies &id=4714691](http://ezinearticles.com/?Small-Business-Venture-Capital-Strategies&id=4714691).

The financial statement, particularly the profit margin, is obviously important to venture capitalists, but they will also be looking at other factors. The quality of the management team identified in the business plan will be examined. They will be looking at the team’s experience and track record. Other factors needed by venture capitalists may include the projected growth rate of the market, the extent to which the product or the service being offered is unique, the overall size of the market, and the probability of producing a highly successful product or service.

Businesses that are seeking financing from banks know that they must go to loan officers who will review the plan, even though a computerized loan assessment program may make the final decision. With venture capitalists, on the other hand, you often need to have a personal introduction to have your plan considered. You should also anticipate that you will have to make a presentation to venture capitalists. This means that you have to understand your plan and be able to present it in a dynamic fashion.

Angel Investors

The third type of investors is referred to as **angel investors**⁷, a term that originally came from those individuals who invested in Broadway shows and films. Many angel investors are themselves successful entrepreneurs. As with venture capitalists, they are looking for returns higher than they can normally find in the market; however, they often expect returns lower than those anticipated by venture capitalist. They may be attracted to business plans because of an innovative concept or the excitement of entering a new type of business. Being successful small business owners, many angel investors will not only provide capital to fund the

6. Individuals who provide money for start-up businesses or additional capital for a business to grow. They invest to make not only a profit but also returns that are substantially above those found in the market.

7. Individuals who initially invested in Broadway shows and films. As with venture capitalists, they are looking for returns higher than they can normally find in the market; however, they often are expecting returns lower than those anticipated by the venture capitalist.

business but also bring their own expertise and experience to help the business grow. It has been estimated that these angel investors provide between three and ten times as much money as venture capitalists for the development of small businesses. “The Importance of Angel Investing in Financing the Growth of Entrepreneurial Ventures,” *Small Business Notes*, September 2008, accessed October 10, 2011, www.smallbusinessnotes.com/aboutsb/rs331.html.

Angel investors will pay careful attention to all aspects of the proposed business plan. They expect a comprehensive business plan—one that clearly specifies the future direction of the firm. They also will look at the management team not only for its track record and experience but also their (the angel investor’s) ability to work with this team. Angel investors may take a much more active role in the management of the business, asking for positions on the board of directors, taking an equity position in the firm, demanding quarterly reports, or demanding that the business not take certain actions unless it has the approval of these angel investors. These investors will take a much more hands-on approach to the operations of a firm.

KEY TAKEAWAYS

- Planning is a critical and important component of ensuring the success of a small business.
- Some form of formal planning should not only accompany the start-up of a business but also be a regular (annual) activity that guides the future direction of the business.
- Many small business owners are reluctant to formally plan. They can produce many excuses for not planning.
- Businesses may have to raise capital from external sources—bankers, venture capitalists, or angel investors. Each type of investor will expect a business plan. Each type of investor will be more or less interested in different parts of the plan. Business owners should be aware of what parts of the plan each type of investor will focus on.

EXERCISE

1. In Exercise 2 in [Section 5.1 "Developing Your Strategy"](#), you were asked to interview five local business owners. In addition to asking them questions about strategy, ask them the following questions about planning: (a) When you began the business, did you have a formal plan? (b) If not, why not? (c) Do you conduct some form of planning regularly?

5.3 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.

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

Video Clip 5.9

How to Write a Business Plan

[\(click to see video\)](#)

Cartoon introduction to building a business plan.

Video Clip 5.10

How to Write a Business Plan in 6 Minutes—Template

[\(click to see video\)](#)

Voiceover PowerPoint video.

Video Link 5.1

Writing a Business Plan—Bloomberg: Your Money

A brief video from Bloomberg’s Business of Life program.

www.videopediaworld.com/video/45083/Writing-a-Business-Plan—Bloomberg-Your-Money

Video Clip 5.11

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

[\(click to see video\)](#)

A video from 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://www.census.gov).
- *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.
- *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).** 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**⁸ and **quantitative forecasting methods**⁹. 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 5.2 "Overview of Forecasting Methods" 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 5.2 Overview of Forecasting Methods

Technique	Description	Strength	Weakness
Qualitative Sales Forecasting Methods			
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	Difficult to use in some business-to-customer (B2C) environments. Sales force members are

8. Methods that assume that one does not have historical data or cannot rely on past historical data.

9. Methods that consist of techniques that assume you can use past data to make projections of the future.

Technique	Description	Strength	Weakness
		idea of their intentions to buy. Its greatest strength is in the B2B environment.	compensated when they meet their quotas, but this might be an incentive to “low-ball” their estimates.
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	Experienced individuals should do these. They can take time to conduct and are relatively expensive.

Technique	Description	Strength	Weakness
		accurate in the short term.	
Quantitative Sales Forecasting Methods			
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.
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	Can be used to forecast and examine	Requires extensive data, computer software, and a

Technique	Description	Strength	Weakness
	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.	the possible validity of relationships, such as the impact on sales by advertising or price.	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 5.12

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

[\(click to see video\)](#)

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

Video Clip 5.13

Sales Forecast, Part 1: Structure

[\(click to see video\)](#)

Tim Berry starts a discussion about using spreadsheets for forecasting.

Video Clip 5.14

Sales Forecast, Part 2: Logic

[\(click to see video\)](#)

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

Video Clip 5.15

Sales Forecast, Part 3: Back to the Spreadsheet

[\(click to see video\)](#)

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

Web Resources for Forecasting

- **Three methods of sales forecasting** (sbinfocanada.about.com/od/cashflowmgt/a/salesforecast.htm). This site provides three simplified approaches to sales forecasting.
- **Forecasting in business** (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). 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). 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**¹⁰ 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 businesspeople, 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

10. The introduction to the business plan that describes the company’s business, the intended customers, the legal structure, the type and amount of funding that will requested, and the capabilities of the key executives.

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**¹¹ 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**¹², 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?

11. A document that articulates the long-term purpose and idealized notion of what the business wishes to become.
12. A document that articulates the fundamental nature of the business. It should address what business the company is in, the company’s potential customers, and how customer value will be provided.

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. 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.

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 skill sets; 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.

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 [Chapter 9 "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**¹³ 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 [Chapter 10 "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.

13. A report that provides an examination of the overall profitability of a firm over a particular period of time.

14. A report that examines the assets, liabilities, and owner's equity of the business at some particular point in time.

Balance Sheet

The **balance sheet**¹⁴ 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**¹⁵ 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

15. A document that maps out where cash is flowing into a firm and where it flows out. It recognizes that there may be a significant difference between profits and cash flow.

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 [Chapter 10 "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.

One way for an organization to deal with significant changes is a process known as **scenario planning**¹⁶. 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 [Chapter 2 "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.

16. A process that examines the impact and possible responses to events that may be unlikely but that would have significant impact on a business.

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. 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 [Section 5.1 "Developing Your 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 ([Chapter 16 "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.)
 - a. Read his executive summary and critique it. How would you improve it?
 - b. Evaluate the document's vision and mission statements. Are there any major problems? How would you improve them?
 - c. 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?

5.4 The Three Threads

LEARNING OBJECTIVES

1. Learn that the planning process can add significantly to the delivery of customer value.
2. Understand that the proper management of the cash flow of a business can occur only in an environment of comprehensive planning.
3. Understand that although not all businesses will rely on e-business or e-commerce, they should carefully plan their inclusion into a firm's operations.

The business plan is the backbone of both start-up and existing businesses. The initial business plan forces one to consider the core issues in detail. These issues directly relate to the themes that are stressed throughout this text: customer value; cash flow; and digital technologies, e-commerce, and e-business. Building a good initial business plan requires the author(s) to seriously consider these three themes. It must be pointed out that these themes *must* be reviewed regularly as part of a continuous planning process. A great mistake of many small businesses is that they may begin with a formal plan, but they abandon the concept after receiving initial funding. Regardless of the industry or the business size, formally thinking about these themes in the context of planning is essential.

Customer Value

Businesses survive because they provide value to customers. To begin a business, one should have a clear vision as to what constitutes value to the targeted customers. The initial business plan must be able to articulate this vision. However, that notion of value can change over time. Customers' perceptions of value can evolve or change radically. Competitors can change what they offer customers, and the firm itself can acquire or lose capabilities that were used to provide value. This shifting value landscape does not allow any business to adhere to its initial plan as though it were dogma. Evaluations of customer value must be conducted regularly as part of an annual planning process.

Cash-Flow Implications

It cannot be repeated too often nor overemphasized: the survival of a small business often hinges on its ability to successfully manage its cash flow. Balancing cash

inflows with outflows is not something that can be done in an ad hoc fashion. It requires a plan. Because one cannot count on accuracy in long-range forecasts, or even short-range forecasts, examining your cash flow must become part of an ongoing planning process. The text has promoted the idea of small businesses having annually updated plans. In the case of cash-flow calculations, it might be advisable for small firms to update their cash-flow analyses monthly.

The Influence of E-Commerce and E-Business

Not all firms will have the same commitment to e-commerce or e-business options. The level of commitment will be determined not so much by size, but by the nature of the business, the knowledge and experience of the owner(s) and the management team, and the firm's growth objectives. However, given the declining costs for website development and hosting, and the increasing ease of using tools such as social media, web store sales management, and **customer relationship management**, Efraim Turban et al., *Electronic Commerce: A Managerial Perspective* (Upper Saddle River, NJ: Pearson/Prentice Hall, 2008), 759. it would be odd if these options were not considered in the planning process. This is not to say that all small businesses must include them in their initial business plan, but the integration of e-commerce or e-business can be an evolutionary process that can be made much easier by thoughtful planning.

KEY TAKEAWAYS

- The planning process for a small business must always incorporate the notion of customer value and recognize that this notion can change over time.
- The proper management of a firm's cash flow requires a commitment to planning the management of one's cash flow.
- Although e-business and e-commerce options may not be considered in the original plan for a business, if they are eventually considered, their successful implementation will require a detailed plan.

EXERCISES

1. In Question 2 of Exercise 5.1, you were asked to interview five local business owners. Ask them how they manage to identify how customer needs might change over time and how they would plan on responding to such changes.
2. While interviewing them, ask how they go about managing their cash flow. Ask how far ahead they plan their cash-flow management.
3. If they have a website, ask how they planned for its creation and use.

Disaster Watch

The man who is prepared has his battle half won.

- Miguel de Cervantes

When failure is not an option, then planning is a necessity. A well-built plan enables the management team of a business to fully anticipate what problems they may encounter and what will be required of them to make the firm successful. There are an almost innumerable number of factors that can become a disaster for a business, but solid planning can significantly reduce that number. A good plan should also force the owner and the management team to anticipate major areas of concern that can become disasters, such as the following:

- **Are the participants ready?** For the prospective first-time business owner, the task of building a business plan should provide valuable insights into what will be required to make the business function. The plan should indicate the necessary initial funding and the work commitment necessary for success.
- **Unrealistic expectations.** A thoughtful plan should eliminate assumptions or outcomes that cannot be supported after careful consideration or analysis. It may be sound that your sales will grow by 100 percent every year for five years or that you will recoup your investment in six months, but some simple running of numbers might show that those are impossible outcomes. Simply “forcing” someone to articulate such assumptions can help return him or her to a more realistic vision of the world. Better yet, have some outside sets of “eyes”—friends, other businesspeople, your lawyer, or your accountant—review the plan.
- **Determining whether the business will be profitable.** The financial analysis section of your plan should indicate when a start-up will become profitable or how much profit a business will make. This is of great importance to potential investors and to the owner.
- **Not truly understanding the market by failing to know how customers determine value.** The business plan requires that one clearly identifies who the targeted customers are and how the business will provide greater value than its competitors. Plans

force owners and managers to specifically articulate how they will serve their customer base. Without clearly stating these key points, any business is headed for disaster because having some sort of “hunch” or “idea” about your customers and their needs is not enough.

- **Failure to adequately capitalize the business.** The overwhelming consensus is that small businesses “fail” for two main reasons: inadequate management (often attributed to a failure to plan) and insufficient capitalization. Start-ups often underestimate the required capital to begin operations and continue operations for the foreseeable horizon. A structured plan requires them to consider what will be needed during the next few years.
- **Not determining the cash flow.** The lifeblood of any business is its cash flow. This is particularly true for small businesses. Anticipating a firm’s cash inflows and outflows is not something that can be handled in an intuitive fashion. It requires analysis. Misjudging these two flows is, perhaps, the surest recipe for disaster.
- **Failure to create the appropriate management structure.** Small-business owners are often accused of wanting complete control of all aspects of their firm’s operations. For micro-sized small businesses, this may be feasible, but as the firm’s size increases, it is critical that lines of responsibility be clearly drawn. Managers and employees must know what is expected of them and their responsibilities. A failure to do so produces confusion and conflict—another good recipe for disaster. If the formal delineation of the management structure is not part of a plan, then it is highly unlikely that necessary clarity will arise spontaneously.

Managers in businesses both small and large often complain of “firefighting” problems; unfortunately, many of these problems are a result of inadequate or nonexistent planning. In the case of the smaller enterprise, a small blaze can rapidly become an inferno that can lead to disaster. According to a report released by the Epicurus Institute, “when a business starts or operates without a plan, the principles are not prepared to deal with the slightest problem that can affect their business.”