

**A GUIDE TO  
PREPARING A BUSINESS PLAN  
FOR  
RAISING FINANCE**



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## **BUSINESS PLANNING - A PROCESS, NOT A DOCUMENT**

Business planning is a process through which management establishes corporate goals, set objectives, evaluates the internal and external operating environment, and develops strategies and action plans for the future development of the business. It is a process, which is iterative and by nature may take considerable time and involve the collection and analysis of a great deal of data.

This document is not concerned with the *process* of business planning but is intended to provide practical guidance on how to produce a written business plan for the primary purpose of raising finance. However, the process often benefits from participation by someone outside the business to help guide management through the various steps. If you are the manager of an existing business or an entrepreneur anticipating a new business venture and would like us to assist you in the business planning process, please feel free to contact us.

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### **Writing the business plan - some key questions**

- ***Who should write the business plan?***

Private Equity houses and other sources of finance generally assume that successful businessmen are capable of writing their plans down on paper! You should therefore write the document but you may need some help and advice from us in deciding on an overall format and structure. Where a team approach is to be adopted, specific responsibilities need to be assigned to individuals together with pre-determined deadlines.

- ***Should the plan be in glossy covers?***

While glossy covers are not essential it is important that you present a professional looking plan which captures the interest of the reader. It should be printed and bound. All efforts to improve presentation with the use of page numbers, graphics, etc will impress potential backers and generate credibility. However, you should remember that producing such a document is only the first step in a process, which is designed to examine all aspects of the venture including the quality and experience of the people behind it.

- ***How long should it be?***

There is no definitive guideline as to how long a plan should be but the aim is to keep it as short and as simple as possible but at the same time to cover the subject adequately. Much of the detailed information can be relegated to the appendices. Overall a well-written plan may be anything from fifteen to forty pages in length, plus appendices.

- ***Is the business name important?***

Careful thought should be given to naming a new business. The name should reflect the major type of business, or be distinctive in some way, such as APPLE computer. In addition, trademarks should be identified and registered. A subsequent search by a lawyer to see if the name or trademarks are available for use should be undertaken early.

- ***How can I forecast future results?***

Many entrepreneurs feel that forecasting the results of a business for the next five years ahead, particularly where a new venture is involved, is an impossible task. This is usually because they assume that the primary purpose of the exercise is to forecast future results to which they will be held, whereas the principal value of such *projections* is to help quantify the financial implications of the plan and to provide a means of measuring future performance, based on the assumptions set. It is recognised by financiers that the environment in which a business operates is subject to changing factors and the assumptions underlying projections must therefore similarly be capable of change. Nevertheless, prospective investors will use the projections to gauge whether the investment is capable of meeting their required rate of return.

- ***Should I be optimistic or pessimistic in my projections?***

It is advisable to aim for the middle road and to be as realistic as possible in compiling financial projections and particularly those relating to sales revenue. If in doubt be conservative! The problems of estimating future costs are well recognised and it is acceptable to include a contingency in the projections and gauge the financial risk implicit in them by assessing the impact of changes in the key assumptions. The most important consideration for you is not to underestimate the cash requirement.

- ***Should my projections allow for inflation?***

It is often argued that by ignoring the effect of inflation on both sales revenues and costs there will be no distortion of the financial projections. Whilst it is certainly easier to ignore inflation this may prove misleading if the prices of certain items in the projections are expected to rise faster or slower than the general rate of inflation. In addition, where price increases are expected to be significant an understatement of the working capital requirement could arise. In all cases therefore we would advise that effects of inflation should be carefully considered, and in most cases built into the projections.

- ***What should the plan cover?***

Unless you have had previous experience of writing a business plan to raise finance then it is possible that you are not aware of what such a document should look like. To help you with this problem we set out below a general outline of what should be covered and how it should be structured. In considering each point in the outline you will be preparing the answers to many of the questions that are likely to arise in your later discussions with potential investors, or during the early operational phases of the business. In some situations only part of this outline may be appropriate and in all cases you should tailor the plan to your specific circumstances.

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## **Writing the business plan – the key messages to convey**

This should be dealt with in substance in the main body of the plan but highlighted in simple but effective terms in the Executive Summary. They are the points that will encourage the first time reader of the plan to read beyond the Executive Summary.

- ***What will my business look like in five years time?***

This will convey management's Vision for the future. It will deal with market share, scale of operations, the type of services/products you will be selling and customer perceptions.

- ***What sets us apart from our competitors?***

This conveys your Unique Sales Proposition or USP. It deals with the products/services you provide and the manner in which you provide them as regards your customers, personnel and people in the industry.

- ***What are the principal ingredients of our success?***

What are the reasons for your successful performance to date and how do you plan on building on these strengths in future?

- ***Do we have the skills we you need?***

What skills will you need to implement your strategy and how are the existing management team able to meet these requirements? What additional skills will you therefore need to recruit or develop from within?

- ***How will our financial performance improve?***

The difficult one! To what extent will your financial performance improve? Explain how and describe any further capital you will require.

- ***What are the risks?***

What are the principal risks and how do you plan to mitigate their financial impact if they crystallise? How will these impact on financial performance?

# OUTLINE, CONTENT AND STRUCTURE

## Overview

This section should not be a mere listing of topics but should emphasize the key points of your proposal, including: -

- the purpose of the plan (e.g. to attract potential investors);
- the company's ultimate goal and its distinguishing features which will be critical in achieving this goal;
- the size and type of market the project is aimed at;
- significant product / service features;
- milestones;
- financial projections, such as 'achieving turnover of £3m in 1994, breaking even in the second half of 1995, and growing to £9m turnover and £2m after tax profits by 1997';
- funding requirements.

The overview should be a succinct summary of the business plan, which will allow investors to make an initial assessment of the risk associated with your business. The major technical, operational and financial milestones represent 'risk reduction' points. Achievement of these milestones will add substantial credibility that the company will succeed in the future.

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## Contents

This should be included to assist readers in locating specific sections and points in the plan.

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## Company description

This section should give your potential investors specific details of your objectives so that they have good reasons for believing that you will succeed.

Since all professional investors have excellent alternative opportunities you must show that your chances of success are substantially better.

It should provide answers to the following questions :

- What business are you in?
- What are your principal
  - products or services?
  - markets?
  - applications?
- What are the major factors that will distinguish you from your competitors and account for your success?

Your answer to the last point should link the distinguishing features of your product to a market need. Examples including the following :

- 'Our software technology makes it easy for a customer to convert from his existing obsolete system to new hardware. This will meet an important need because conversion has been one of the industry's major problems.'
- 'Due to the technological and manufacturing breakthrough, we will have the lowest cost product in a market that is very price sensitive.'
- 'We have very strong business relationships with design engineers for customers that order £5 million a year, and our product solves numerous problems inherent in developing their new product lines.'

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## **Market analysis and marketing**

This section on marketing and market analysis is often of critical importance. Probably the most common single error is to assume you can validly predict what you can sell by gathering some general numbers of the size of the market, and then projecting a market share for yourself. Unless you can back up your projections with detailed answers to the kind of questions asked below, you will be unconvincing and possibly wrong.

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## **Industry description and outlook**

- What industry are you in?
  - How big is it now? How big will it be in five years time? Ten years?
  - What are its chief characteristics?
  - Who are, or will be, the major customers? Are they large industrial companies, or are they small proprietorships?
  - What are, or who will be, the major applications of your product or service?
  - What are the major trends in the industry?
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## **Target markets**

- What are the major areas you will target?

Analysis of market segmentation may be one of the most significant parts of the plan. Major mistakes have been made in this area. Some common ones include: -

- In many markets twenty per cent of the customers may represent ninety per cent of the demand. Ignoring such factors may well result in the marketing being ineffective.
- Lack of clear definition of the products or services to be sold.
- No accurate estimate of the profitability of each project or service.

You must demonstrate an understanding of the market and your particular niche within it.

- For each major product or service what are the following :
    - Customer requirements?
    - Methods of meeting these requirements?
    - Buying habits of the customer?
    - Impact on the customer of using your project or service?
    - How much will it save him per year? What return on investment will he get?
    - Other impacts (Will he have to change his way of doing things? Buy other equipment? Change his work habits? Modify organisational structure?)
  - How will the market segments and uses of your project change over the next three or five years?
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## **Competition**

- What companies will you compete with (including future entrants to the market)?
  - How do you compare with other competitive companies?
  - What competition will you meet in each product or service line?
  - How does your product or service compare with others (especially through the eyes of the customer)?
  - What is the market share of each existing competitor?
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## **Marketing activities**

What are your plans for :

- Marketing strategy (specialisation, market share objectives, image)?
- Distribution (direct, retail)?
- Promotion (public relations, attendance at trade shows)?
- Advertising (what is the best method, television, trade magazines, will you employ an advertising agency)?

- Pricing (demand pricing or cost-based pricing, volume discounts, how will pricing change over time)?
  - Geographical penetration (domestic, Europe, USA, etc)?
  - Setting priorities among segments, applications, marketing activities? The limited human resources in a new venture cannot be all things to all people, regardless of the opportunities.
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## **Selling activities**

- How will you identify prospective customers? Consider not just the companies, but the relevant decision-makers who can spend money on your product, from either discretionary or budgeted funds.
- How will you decide who to contact and in what order? Who will make these decisions?
- What level of selling will you have (for example, the number of sales personnel)?
- How efficient will the selling operation be (for example, how many calls per sales-person)? Directly linked to this is the number of calls or demonstrations required to produce a sale?
- How long will each of the above activities take in man-days?
- What will your initial order size be? What is the likelihood and size of repeat orders?
- Based on the above assumptions, what is the sale productivity of each sales-person?
- What is the commission structure for the sales personnel? Do they have increasing or decreasing rates for exceeding quota? What will the average sales-person earn per year and how long will he have to wait to receive commissions?
- For retail operations, where will the shops be sited? How large will they be? How many sales-persons will there be per shop?
- What evidence do you have to back up the above estimates?

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## **Reaction from specific prospective customers**

- What prospective customers have you talked to?
  - What was their reaction?
  - Have they seen or tested a realistic prototype of the project or service?
  - If so, what was their reaction?
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## **R & D - future development of products / services**

This part of your plan should give an indication of the potential for significant future growth in the business from developments yet to take place or be completed. The normal development cycle of a project will take the following path :

- research produces an idea;
  - this idea is formed into a prototype model, which is tested for technical and market feasibility;
  - if viable, funds are committed to develop it;
  - the idea is developed;
  - a saleable product is produced;
  - providing the product is successful, demand becomes stable.
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- What stage of development have your products reached?
  - What are the key research and development activities and the related milestones and risks?
  - What new products, hopefully derived directly from first generation products, do you plan to develop to meet changing market needs?
  - What new technologies or scientific approaches exist that may become practical in the next five years? What factors limit their development or acceptance?

One common pitfall here is to compare the technology you are working on now and will have on the market in a year or two, with that which the competition has now. Instead, you should compare what you will have by the time you are in the market with what others will have then.

- What is your patent or copyright position?
    - how much is patented or copyrighted?
    - how much can be patented or copyrighted?
    - how comprehensive and how effective will the patents or copyrights be?
    - which companies have the technology that is superior or equal to yours?
    - are there additional means of protecting your technology (such as non-disclosure agreements or speed in putting out the product or service?)
  
  - Are there any regulatory or approval requirements?
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## **Manufacturing and operations**

- How will you accomplish production or conduct service operations?
  - how much will you do internally and by what method?
  - how much through subcontractors, both initially and after one or two years?
  
- What production or operating advantages do you have?
  
- What is your present capacity for the level of production or operations? How can this be expanded?
  
- What are the critical parts? Are any of these parts dependent on one supplier or do you have alternative sources? What are the lead times of these parts?
  
- What are the standard costs of production at different volume levels?

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## Management and ownership

In the early stages of business the investor is investing in people, therefore this section requires careful thought.

- Who are your key managers?
- How do you intend to attract and compensate key people (i.e. share options, incentive bonuses etc)?
- What are their skills and, particularly, their experience, and how does this relate to the success of your venture?

You should think carefully about these issues for two reasons. First, it is extremely important to differentiate between ownership and management roles, even when assumed by the same individuals. Second, it may be better to defer employing an individual rather than have the job outgrow him in a year.

- What has their experience been, and how does this relate to your requirements?

The most common problem here is failing to relate to your team's capability to the success of your business. As an example, the chief engineer might be described as having a fine education and important-sounding job titles with sophisticated companies, but with no mention of work he has actually done. This information does not directly substantiate that he really could design the complex product necessary for the company.

- What staff additions do you plan, when, and with what required qualifications?

For example, you may not have a candidate for the position of financial controller yet or even need one immediately - but it is important to state your plans to support this function when required.

- Do any managers have outstanding 'non-complete' agreements with previous employers?

If so, get legal advice regarding the validity of applicability of these agreements.

- Who is on your board of directors?

- It is important to think ahead about the role of your board when you become operational, it may be inappropriate to have certain early investors serve on the board if their sole contribution is that of providing finance.
- Who are your current shareholders, and how many shares does each own? (Include comments about options and related prices).

While it may be necessary or expedient to permit investment by many small and / or unsophisticated investors, their presence may cause concern among professional investors or headaches or diversion of management effort during the evolution of the company.

- What amount of share capital is currently authorised and issued?

### **Organisation and personnel**

- How many employees will you require? Consider the different levels of ability that you will require.
- What will your recruitment policies be and how will you train new employees?
- Will your employees be affected by any legal, trade or union requirements?
- Show sample organisational structures for the initial years and thereafter.
- What levels of remuneration will you offer?

### **Funds required and their uses**

- How much money do you require now?
- How much will you require over the next five years, and when will it be required?
- How will these funds be used?
- What portion of the funds is expected to be raised from debt rather than equity?
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- How will you raise further outside investment in the future?
  - organised markets: full listing
  - private placing
  - bank and other debt finance

The stringent company law and Stock Exchange regulations restrict the number of companies who will be in a position to obtain a full Stock Exchange listing in their early years.

It is also possible for a company to raise finance privately through a broker or other sponsors who will place the shares. The main advantage of this is that the company can remain private and normally no prospectus is required. The disadvantage is that the sponsor only approaches a limited number of potential investors.

## **Financial data**

This section is particularly important - it summarises the financial consequences of your plans. The assumptions behind your projections are critical and require careful thought. Too much financial information however can be worse than too little, therefore each company must project those figures it believes are most appropriate. Some of the detailed financial data may be included in the appendices.

- Present historical accounts (if any) and projections for the next three to five years, including
  - Profit and loss statements by month or quarter, at least until break-even, and then quarterly or annually to cover a five-year period. (It is common to present monthly statements for the first year, quarterly statements for the next two years, and annual statements for the last two or three years.) The break-even point should be clearly identified.
  - Balance sheets at the end of each year
    - cash flow projections;
    - capital expenditure forecasts for equipment, etc;
    - manufacturing / delivery plan (including the state of the order book).
- Present the assumptions on which the above figures have been based.

- What *key* assumptions have been made in your projections, and how good are they?
    - Do they reflect the industry performance? (if not specific, justification should be given)
    - Are they 'optimistic' or 'pessimistic' numbers (or preferably something in the middle)
  - Test the data using several different assumptions to determine the reasonableness of the final information.
  - Provide a sensitivity analysis for key factors (for example, show how the funding requirements would differ if any of the major milestones were missed by three months).
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### **Appendices or exhibits** (as required)

- Summaries of the training and experience of key managers.
  - Pictures or sales literature of the product / prototype.
  - Professional references.
  - Market studies, articles from trade journals.
  - Patents.
  - Financial data.
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## **MAKING USE OF THE PLAN**

Business plans have two main uses : as an internal operating plan for management; and as an external document to assist in raising finance. As noted earlier, this publication is concerned primarily with the latter but is not intended to cover all the implications of raising finance. However, it may be helpful to deal with some of the more general questions which you might wish to ask :

- ***Who should we send the plan to?***

Whether the document should be sent to a bank or similar lending institution or to a prospective investor is determined by the use to which the funds are to be put (and therefore the type of funds sought), and partly by the amount that management wish to raise. Care should be taken when sending such a document to individuals to ensure that the provisions of the Financial Services and Markets Act 2000 (FSMA) are complied with and in particular that the document is approved as a financial promotion. In addition, it is important to have regard to the Companies Act which requires all offers of securities to the public to be accompanied by a prospectus. Copies of the plan should be controlled and distribution recorded.

- ***What sort of return will a private equity house require?***

Private equity houses invest in unquoted companies many of which are relatively immature businesses. The risks of such investments are considerable and they naturally suffer a number of failures among their investments. This means that the level of return required from successful investments to compensate for those which result in failure, is high and typically in the range of 30% to 60% per annum compound. The lower end of this range might be appropriate for an existing relatively mature business whereas the upper end would apply to a high-risk start-up venture. A required rate of return of 40% per annum means that the investor expects the value of his investment to increase five fold over a five-year period!

- ***The management team can only invest a relatively small amount of capital - how can we retain a significant equity share in the business?***

Private equity houses and other equity investors are familiar with this situation - it is rare except in the smallest of ventures that management is able to put up more than a minority share of the required funding. However, such investors are aware of the need to retain the motivation of the

management team and will always wish to ensure that they are left with the potential for a return, which at least matches that of the investor and usually exceeds it.

Such returns of course will only be generated if the venture achieves substantial growth, and it follows that projects which show only modest levels of profitability and return will not be of interest to venture capitalists.

- ***How should we structure the finance required?***

Management teams are often concerned that they should suggest a suitable financial structure for the required finance. However, in practice most investors will wish to make this judgement themselves so as to meet their required rates of return and other investment criteria. While it is not necessary therefore for management to be overly concerned with this aspect it is advisable that they consider the amount of debt which the venture will bear subject to cashflow and security considerations, thereby minimising the amount of equity required.

- ***How much cash will management be required to put up?***

There are no definite rules on this. In principle, the outside investors will look for a significant financial commitment of the founders / management and in absolute terms this will vary according to the wealth of the individual concerned. Commitment can of course be demonstrated in other ways. For example, time, effort and money spent in bringing a project to the point when it can be presented to outside investors, so called 'sweat equity' might well go a long way to demonstrating the commitment of management. Of course often management will already own a large stake in the business or indeed the entire business e.g. where they originally set up the business.

- ***What is due diligence?***

This is a term which refers to the investigation and appraisal procedures adopted by prospective investors and lenders prior to making an investment/loan. Such procedures will extend not only to checking out the individuals concerned but also to an examination of all other aspects of the project. Often industrial / technical specialists are employed to help assess the technological and market aspects of a project.

- ***How long will it take to raise finance?***

This depends partly on the nature of the funding proposal - clearly an existing business raising additional debt finance from its current bankers may do so in far less time than a new green field site project raising venture capital. Typical time scales for the latter range from three to six months or even longer in some cases. However, most venture capitalists are geared up to give an early indication after receipt of the business plan of whether they are seriously interested in pursuing the proposal.

- ***Must I have the full management team in place before approaching investors?***

No - but it certainly helps. Where gaps exist in the management team these should at least be identified and the steps necessary to fill them outlined.

- ***What should I do now?***

If you are proposing to seek finance for a business venture, whether a start-up, a management buy-out, management buy-in, or your existing business, why not call in to discuss your plans with us.

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# AN EXAMPLE OF A CONTENTS LIST

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## Executive Summary

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### Company

- Business type
  - Principal products or services, markets and applications
  - Distinguishing features which will lead to success
- 

### Market analysis and marketing

- Industry description and outlook
  - Target markets
  - Competition
  - Reaction from specific prospective customers
  - Marketing activities
  - Selling activities
- 

### Research and development - new products and technology

- Stage of development
  - Key research and development activities
  - Future product developments
  - New technology
  - Patent or copyright position
  - Regulatory or approval requirements
- 

### Manufacturing and operations

Product and service procedures

Production advantages

Production capacity

Critical parts and suppliers

Costing

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## **Management and ownership**

- Key managers
- Employees
  - Recruitment
  - Compensation
  - Experience
  - Future requirements
  - Prior agreements
- Directors
- Shareholders

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## **Organisation and Personnel**

- Staff numbers by category
- Organisation structure
- Compensation by category

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## **Funds required and their uses**

- Immediate requirements
- Five year requirements
- Use of funds
- Debt and equity capital
- Public quotation timing

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## **Financial data**

- Historical accounts and projections
- Assumptions made
- Sensitivity analyses

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## **Appendices**

- Biographical details of key managers
  - Illustrations of the product
  - Professional references
  - Market studies, relevant articles from trade journals
  - Patents
-