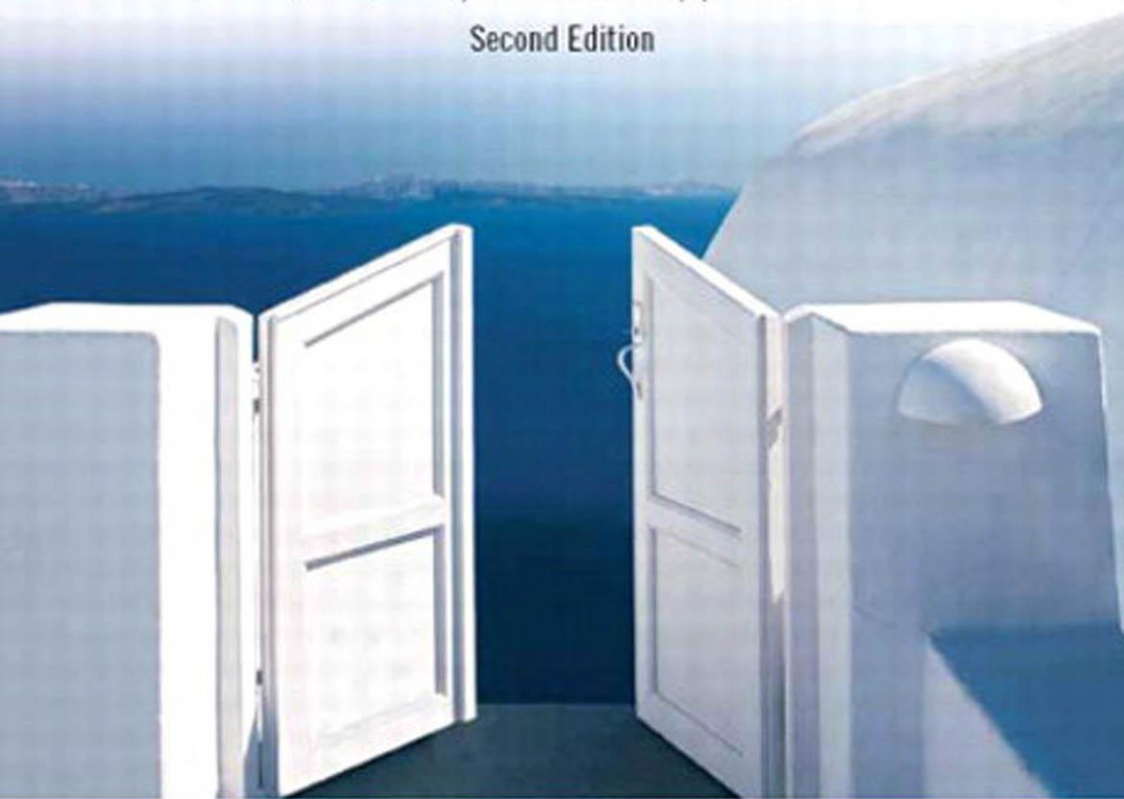




Preparing Effective Business Plans

An Entrepreneurial Approach

Second Edition



Bruce R. Barringer

PREPARING EFFECTIVE BUSINESS PLANS

AN ENTREPRENEURIAL APPROACH

SECOND EDITION

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Oklahoma State University

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Dedication

To my wife Jan, my best friend

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PREFACE

THE SURGE IN INTEREST IN ENTREPRENEURSHIP ON COLLEGE CAMPUSES AND BEYOND

There is tremendous interest in entrepreneurship on college campuses and around the world. In academia, some 2,000 colleges and universities in the United States, about two-thirds of the total, now offer a course in entrepreneurship. As a result, a growing number of students are forgoing traditional careers and starting their own business. Ordinary citizens are equally interested in starting entrepreneurial careers. According to the 2012 Global Entrepreneurship Monitor, in the United States a total of 13 percent of the adult population (ages 18–64) either is starting a business or has started a business in the past 3 ½ years. There are regions of the world where the percentage is even higher. For example, in Latin America and the Caribbean 17 percent of the adult population, on average, either is starting a business or has started a business in the past 3½ years.

NEW TO THIS EDITION

- Fresh material that explains the business startup process, from the original inception of a business idea to a fully fleshed-out business plan
- New or updated Business Plan Insight boxed features
- Revised and updated business plan for Prime Adult Fitness, the fictitious fitness center for people 50 years and older, that is completed step-by-step throughout the course of the book
- New and updated Application Questions at the end of each chapter
- New and updated examples, embedded in each chapter, that illustrate the issues that business plan writers grapple with
- An updated Internet Resource Table (Appendix 2.2), which provides students access to online resources to assist them in completing a First Screen analysis and a complete business plan

THE IMPORTANCE OF BUSINESS PLANS

An important tool that helps people who intend to start a new business is a business plan. A business plan is a written document that carefully explains every aspect of a new venture. Although many entrepreneurs and small business people do not write a business plan before they start their business, it's highly recommended. For most businesses, a business plan serves two functions. Inside the firm, the plan helps a company develop a "blueprint" to follow in executing its strategies and plan. Outside the firm, it introduces potential investors and other stakeholders to the business opportunity the firm is pursuing and how it plans to pursue it.

OBJECTIVES OF THE BOOK

The objectives of this book are twofold. The first objective is to help students and others learn how to write a business plan. This book provides step-by-step instructions for writing a plan. Second, the book immerses its reader in the process of thinking through the issues that are important in starting a business. This objective may be the most compelling advantage of the book. A full business plan is written, chapter-by-chapter, as an example through the course of the book. The issues that are considered in writing this plan provide a template for others to use as they consider their own business ventures and write their own business plan.

ORGANIZATION OF THE BOOK

The book is organized into four distinct parts:

<i>Part</i>	<i>Topic</i>	<i>Chapters in the Book</i>
1	Starting the Process	1
2	What to Do Before the Business Plan Is Written	2–3
3	Preparing a Business Plan	4–10
4	Presenting the Business Plan	11

DISTINGUISHING FEATURES

A number of distinguishing features set this book apart from other business plan books that are available.

FOCUS ON THE ENTIRE “FRONT END” OF THE ENTREPRENEURIAL PROCESS

Although the primary purpose of the book is to describe how to write a business plan, the entire “front end” of the entrepreneurial process is discussed and defined. The most effective business plans are part of a comprehensive process that includes (1) identifying a business idea, (2) screening the idea (or ideas) to determine their preliminary feasibility, (3) conducting a full feasibility analysis to see if proceeding with a business plan is warranted, and (4) writing the plan. Each step in this process is explained in the book.

FEASIBILITY ANALYSIS WORKSHEETS

Two worksheets are included to help students and others work through the feasibility analysis process. The first worksheet is called the “First Screen,” and helps determine the preliminary feasibility of a business idea. The second worksheet is a full feasibility analysis and is much more comprehensive. Combined, the worksheets represent a sequential way for students to determine the “feasibility” of their business ideas before they enter the business planning process.

SAMPLE BUSINESS PLAN

A business plan, for a fictitious company named Prime Adult Fitness, is built through the course of the book. Every aspect of the plan is described and discussed. This plan will give students and others a solid point of reference as they build their own business plans.

PRESENTING A BUSINESS PLAN

The final chapter in the book provides tips and suggestions for presenting a business plan with confidence and poise. Based on a 20- to 30-minute hypothetical presentation, a 12-slide PowerPoint presentation is provided with suggestions for what to include on each slide.

BUSINESS PLAN INSIGHT BOXED FEATURES

Each of the first ten chapters includes a boxed feature that provides special insights on writing a business plan or launching a new venture.

SUPPLEMENTS

At www.pearsonhighered.com/irc, the following supplements are available to adopting instructors for download. Registration is simple and gives you immediate access to new titles and new editions. If you ever need assistance, our dedicated technical support team is ready to help with the supplements that

accompany this text. Visit <http://247.pearsoned.com/> for answers to frequently asked questions and toll-free user support phone numbers.

- Instructor's Resource Manual
- PowerPoint Presentation

COMPANION WEBSITE

A useful companion website, www.pearsonhighered.com/entrepreneurship, offers free access to teaching resources for all books in the Prentice Hall Entrepreneurship Series, including additional activities, links to latest research, sample entrepreneurship curriculum and syllabi, teaching tips, and Web resource links.

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CourseSmart eTextbooks were developed for students looking to save on required or recommended textbooks. Students simply select their eText by title or author and purchase immediate access to the content for the duration of the course using any major credit card. With a CourseSmart eText, students can search for specific keywords or page numbers, take notes online, print out reading assignments that incorporate lecture notes, and bookmark important passages for later review. For more information or to purchase a CourseSmart eTextbook, visit www.coursesmart.com

ABOUT THE AUTHOR

Bruce R. Barringer is the N. Malone Mitchell, Jr., Chair in the School of Entrepreneurship at Oklahoma State University. He is also the Head of the School of Entrepreneurship. Dr. Barringer obtained his Ph.D. from the University of Missouri and his MBA from Iowa State University. His research interests include feasibility analysis, firm growth, corporate entrepreneurship, and the impact of interorganizational relationships on business organizations. Over the years, he has worked with a number of technology-based incubators and student-led entrepreneurship activities and clubs.

Dr. Barringer's research has been published in *Strategic Management Journal*, *Journal of Management*, *Journal of Business Venturing*, *Journal of Small Business Management*, *Journal of Developmental Entrepreneurship*, and in several other outlets. Dr. Barringer is the author or coauthor of five books, including *Entrepreneurship: Successfully Launching New Ventures*, *Preparing Effective Business Plans*, *The Truth About Starting a Business*, *What's Stopping You? Shatter the 9 Most Common Myths Keeping You From Starting Your Own Business*, and *Launching a Business: The First 100 Days*.

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C H A P T E R

WHY PLAN

INTRODUCTION

On college campuses and around the world, entrepreneurship garners tremendous interest. More than 2,000 colleges and universities in the United States, about two-thirds of the total, now offer a course in entrepreneurship.¹ Across the United States, interest in entrepreneurship is growing, among all demographic groups. According to the Kauffman Index of Entrepreneurial Activity, 320 out of every 100,000 adults created businesses in the United States in 2011. That number translates into approximately 543,000 new businesses being created each month during the year.² Interest in starting a business among young adults is at an all-time high. According to a recent survey, 54 percent of millennials (ages 18–34) either want to start a business or have already started one. That number is even higher for African Americans and Latinos. A total of 63 percent of African Americans and 64 percent of Latinos expressed a desire to start their own company.³

An important tool that helps people who intend to start a new business is a business plan. A business plan is a written document that carefully explains every aspect of a new business venture.⁴ Although some entrepreneurs simply “wing it” and start a business without the benefits of formal planning, experts recommend preparing a business plan. For most new ventures, the business plan is a dual-purpose document used both inside and outside the firm. Inside the firm, the plan helps the company to develop a “road map” to follow in executing its strategies and plans. Outside the firm, it introduces potential investors and other stakeholders to the business opportunity the firm is pursuing and how it plans to pursue it.

The most effective business plans are part of a comprehensive process that includes (1) identifying a business idea, (2) screening the idea (or ideas) to determine their preliminary feasibility, (3) conducting a full feasibility analysis to see if proceeding with a business plan is warranted, and (4) writing the plan. Many

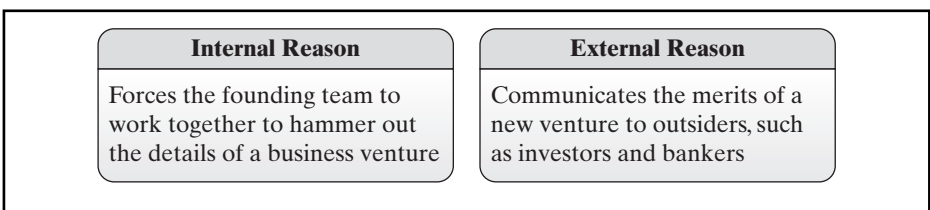
new businesses fail, not because the founders didn't work hard or weren't committed to the venture, but because the idea wasn't a good one to bring with. This process sets forth a specific path for investigating the merits of a business idea. Although the primary purpose of this book is to describe how to write an effective business plan, the second section of the book, titled "What to Do Before You Prepare Your Business Plan," focuses on how to identify and screen business ideas (Chapter 2) and how to test their feasibility (Chapter 3).

Although writing a business plan may appear at first glance to be a tedious process, a properly prepared business plan can save an entrepreneur a tremendous amount of time, money, and heartache by working out the kinks in a business concept before rather than after the business is started. A large percentage of entrepreneurs do not write business plans for their ventures. In fact, a 2010–2012 study of 350 entrepreneurs found that of those that had successful exits (i.e., an IPO or sale to another firm), about 70 percent did not start with a business plan.⁵ Similarly, in a 2002 study, *Inc.* magazine asked the founders of the firms that comprised the *Inc.* 500 that year whether they had written a formal business plan before they launched their companies. A total of 60 percent had not. These statistics should not deter an entrepreneur from writing a business plan. Ample evidence supports the notion that writing a business plan is an extremely good investment of an entrepreneur's time and money.⁶

REASONS FOR WRITING A BUSINESS PLAN

There are two primary reasons for writing a business plan, as depicted in Figure 1-1. First, writing a business plan forces the founders of a firm to systematically think through each aspect of their new venture. This is not a trivial effort—it normally takes several days or weeks to complete a well-developed business plan—and the founders will usually meet regularly to work on the plan during this period. Writing a business plan is also an immersion experience—many founders work late nights and on weekends to get their plan completed. An example of how much work is sometimes involved, and how a well-planned new business unfolds, is provided by Gwen Whiting and Lindsey Wieber, the cofounders of The Laundress (www.thelaundress.com), a company that sells specially formulated laundry detergents and other fabric care products. Wieber and Whiting met at Cornell University

FIGURE 1-1 Two Primary Reasons for Writing a Business Plan



while studying fabrics, and after graduating, the pair decided to start a business together. The following vignette comes from an interview they gave to Ladies Who Launch (www.ladieswholaunch.com), a Web site that highlights the accomplishments of female entrepreneurs:

Gwen: Lindsey and I went to college and studied textiles at Cornell together and always wanted to be in business together. We knew it was going to happen. We always talked about ideas. We were talking about this concept, and it was the right time for us. The first thing we did was the business plan and then a cash flow analysis. We wanted to do as much research as possible before developing the products.

Lindsey: We spent Memorial Day weekend (2003) doing our business plan. We spent the Fourth of July weekend doing our cash flow. After we had our ideas on paper, we went back to Cornell, met with a professor there, and had a crash course in chemistry. She worked with us on the formulation of the products.

Gwen: I found a manufacturer on Columbus Day. Every piece of free time we had, we dedicated to the business. We weren't at the beach with our friends anymore.⁷

The payoff for this level of dedication and hard work, which involved the preparation of a formal business plan, is that Whiting and Wieber have now had a successful business for 10 years. Their products are sold through their Web site and in many stores.

To provide another indication of the value of writing a business plan for the founders of a firm, Table 1-1 shows the contents of the business plan for a fictitious

TABLE 1-1 Business Plan Format for New Venture Fitness Equipment Inc.

<i>Table of Contents</i>		
I.	Executive Summary	1
II.	Company Description	3
III.	Industry Analysis	6
IV.	Market Analysis	10
V.	Marketing Plan	14
VI.	Management Team and Company Structure	18
VII.	Operations Plan	22
VIII.	Product (or Service) Design and Development Plan	25
IX.	Financial Projections	30
	Appendices	
	Summary of Feasibility Analysis, Including Customer Reaction to the Product or Service	
	Supporting Industry Research	
	Resumes of Management Team Members	

■ 4 PART I Starting the Process

company named New Venture Fitness Equipment. This plan is probably similar to the plan that Gwen Whiting and Lindsey Wieber wrote for The Laundress. New Venture Fitness Equipment plans to sell a new generation of fitness machines that will take the boredom out of exercising indoors by equipping its machines (treadmills, stationary bikes, and rowing machines) with flat-panel monitors that will allow exercisers to compete against virtual opponents, in a sort of electronic-game format, on a variety of simulated outdoor courses. Spend a few minutes looking at each of the topics included in Table 1-1, and then imagine the founders of New Venture Fitness Equipment talking through each of these topics. Imagine the debate that will inevitably ensue as the founders grapple with tough issues, such as projecting the size of their industry, specifying their target market, pricing their products, and determining how many machines they will have to sell to break even in each of their first three years. This process forces a team to not only work together but also turn abstract ideas like “these machines are so great they should sell like hotcakes” into concrete realities like “we’ll need to sell 9,850 machines each year during our first three years to break even.” The benefit of this type of intense analysis before a business is started provides a compelling rationale for writing a business plan. This sentiment is affirmed by Guy Kawasaki, a well-known Silicon Valley entrepreneur and venture capitalist, who wrote:

All the late-night, back-o’-the envelope, romantic intentions to change the world become tangible and debatable once they’re put on paper. Thus, the document itself is not nearly as important as the process that leads to the document. Even if you aren’t trying to raise money, you should write one (a business plan) anyway.⁸

The second reason a business plan is important is because it is a selling document for a company. It provides a mechanism for a young company to present itself to prospective investors, business accelerators and incubators, suppliers, potential partners, and others. Investors vary in terms of the reliance they place on formal business plans. Initially, many investors ask for an executive summary, which is a 1–2 page overview of a business plan, or they’ll ask for a short set of PowerPoint slides (often called a slide deck) describing the merits of a new venture. If their interest is sufficiently peaked, in some cases they’ll ask for a full business plan and in other cases they won’t. It’s still necessary to have a business plan, however. If an investor commits, in most cases a business plan will be required during the due diligence phase. Due diligence refers to the process investors go through after they tentatively commit to an investment. The commitment is based on a thorough investigation of the merits of the venture, whether any legal complications exist, and whether the claims made in the business plan are accurate and realistic.⁹

As a selling document, a business plan also helps a new company build credibility. For example, imagine that you are an investor and have enough money to invest in one new business. You chat informally with several entrepreneurs at a university-sponsored event for startups and decide that there are two new ventures that you want to know more about. You contact the first entrepreneur

and ask for a copy of his business plan. The entrepreneur hesitates a bit and says that he hasn't prepared a formal business plan but would love to buy you lunch to talk about his business idea. You contact the second entrepreneur and make the same request. This time, the entrepreneur says that she would be glad to forward you a copy of a 25-page business plan, along with a 12-slide PowerPoint presentation that provides an overview of the plan. Ten minutes later, the PowerPoint presentation is in your e-mail inbox with a note that the business plan will arrive by FedEx the next morning. You look through the slides, which are crisp and to the point and do an excellent job of outlining the business opportunity. The next day, the business plan arrives just as promised and is equally impressive.

Which entrepreneur is likely to get your attention? All other things being equal, the answer is obvious: the second entrepreneur. The fact that the second entrepreneur has a business plan not only provides you with detailed information about the venture but also suggests that the entrepreneur has thought through each element of the business and is committed enough to the new venture to invest the time and energy necessary to prepare the plan.

Another way that a business plan helps establish credibility for a firm is by winning or placing high in a university-, community-, or state-sponsored business plan competition or similar event. In the United States alone, more than 50 universities conduct business plan competitions, awarding up to \$10 million in prizes and in-kind services every year. The participants are able to connect with investors and successful entrepreneurs who serve as judges and the winners are typically featured in local newspapers and business publications. Winning or placing high in a competition also sends a message to investors that a startup is worth looking at. For example, when a professor they admired suffered a heart attack, Ray Li, a Rutgers alumnus, and John Vitug, a graduate of Kean University, created an all-natural, low-calorie beverage named Heart Juice that contains ingredients that combat high cholesterol. The two partnered with Shaun Bratton, an MBA candidate at Rutgers Business School, and entered the 2011 Rutgers Business School Business Plan Competition. They were placed second and won \$10,000. Commenting on the value of participating in the competition, Ray Li said:

The Rutgers competition gave us the push to get our product up and running. The award confirmed the belief that we could be successful and win interest from venture capitalists down the road.¹⁰

Over 300 stores now carry Heart Juice, and the number is growing.

There is an emerging school of thought that opposes the idea of writing a business plan, and advocates experimentation and trial-and-error learning gleaned through customer feedback over formal planning.¹¹ This approach, which is associated with the Lean Startup movement, espouses many excellent ideas, particularly in the area of solicitation feedback directly from prospective customers prior to settling on a business idea and a business model to execute on the idea. This book differs from this approach by arguing that a business plan represents an important starting point for a new venture and serves many useful

purposes. It is not intended to be a static document written in isolation at a desk. Instead, it is anticipated that the research conducted to complete the plan will place the founders in touch with potential customers, suppliers, business partners, and others, and that the feedback obtained from these folks will cause the plan to change as it's being written.¹² It's also anticipated that the business will iterate and change after it is launched, based on additional feedback. Some businesses will change more than others, depending on the quality of their initial feasibility analysis and the newness and volatility of their industry. An example of a startup that has relied on its business plan extensively but iterates frequently is Moxie Trades (www.moxietrades.com), a company started by Marissa McTasney, a woman in the construction industry. Ms. McTasney couldn't understand why tradeswomen had to wear ill-fitting men's work boots and clothes, so she started a company that designs and sells work boots and work apparel designed specifically for women. Writing about how Moxie Trades has benefited by having a formal business plan and how frequently the plan changes, author Melanie Keveles wrote in the book *Scrappy Startups*:

Marissa found that she was capable of drawing up a business plan, but she also found that her business plan would work for three months and then it would change. Now, not only does she modify her business plan every six months but she completely changes her strategy along the way.¹³

WHO READS THE BUSINESS PLAN AND WHAT ARE THEY LOOKING FOR?

There are two primary audiences for a firm's business plan. Let's look at each of them.

A FIRM'S EMPLOYEES

A clearly written business plan, which articulates the vision and future plans of a firm, is important for both the management team and the rank-and-file employees. As mentioned above, some experts argue that it's a waste of time to write a business plan and favor trial-and-error learning instead. Although trial-and-error learning is valuable, the process of writing a business plan is often as beneficial as the plan itself, as illustrated through the New Venture Fitness Equipment example. Not only is it useful for a management team to hammer out the contents of a business plan together, but also the process of working together on such an important project can help develop a strong, cohesive team. The process can also uncover potential trouble spots in a team. If particular members of a team can't work together to produce a business plan, it is unlikely they will be successful working together after the business is launched.

A clearly written business plan also helps a firm's rank-and-file employees operate in sync and move forward in a consistent and purposeful manner. The existence of a business plan is particularly useful for a new business that