

Business Plans For Entrepreneurs: How to write a winning script

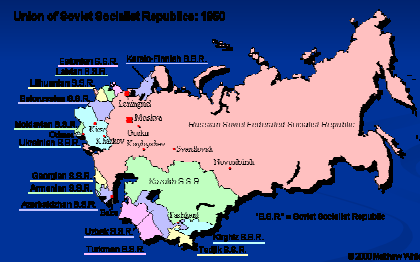
By: Tarek Kettaneh
With Due Credit to Prof. W.Sahlman, Harvard
Business School

March 2009

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The Greater Russia Rally



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The Tools

- The **Internet** is transforming the business landscape:
- Affordable, high speed plumbing
- Democratic and cheap access
- Vast field of opportunity (compare to electricity, steam engine, TV, railways etc...)
- Old things done in new ways: process re engineering
- Transaction cost is the assault weapon
- Faster, better, cheaper

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The Laws

- Moore's law: double the speed, half the cost, every 18 months
- Metcalfe's law: network value is proportional to the square of the number of nodes
- Coase's law: reduction in transaction cost is the foundation of a company
- Tarek's law: anything you can do in 30 seconds with a yellow pad and a pencil, you can do in 30 minutes with a PC.

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The Business Plan

- Translates the dreams of the entrepreneur into a map to follow.
- Is not a collection of spreadsheets with financial forecasts.
- Is the tool which convinces investors to part with their money.



Key Elements of a Good Business Plan

“ P. O. C. D.”

People
Opportunity
Context
Deal

People

- **P**eople who run the Venture
- **P**eople who supply critical services to the Venture

Opportunity

A description of the business proposition:

- What it will sell, to whom, how; how fast it can grow, key drivers of success; obstacles to success.
- Fundamentally, an assessment of the size of the market, its growth, and the competition.

Context

- Founders should describe the big picture in which this business will develop: inflation, taxation, demographic trends, and, in general, variables not under the control of the venture.
- It is up to the founders to explain how the current conditions help or hinder their venture, how they can exploit the “context”:
For example:
 - Lower custom duties
 - Lower taxes
 - Higher interest rates

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Context (Cont'd)

- Telecom rates
- Open sky policy
- Foreign Exchange Rate
- Energy prices
- Upcoming Free Trade Agreements (WTO)

What steps do they plan to take to seize the opportunities or minimize adverse effects?

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The Deal

- The long and arduous road of producing a good Business Plan ends with:
 - A Deal!
- According to Prof. W.Sahlman, sensible deals share 6 characteristics:
 - They are simple
 - they are fair
 - they rely on trust rather than the law.
 - They survive small deviations from Plan
 - They do not contain perverse incentives to behave destructively if things go wrong.
 - They are written on a pile of paper less than 5 mm thick.

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People

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People

- People who run the venture
- People who supply critical services to the venture

Questions about People

- Educational background?
- Previous work experience?
- Accomplishments?
- Reputation?
- Prior experience relevant to task at hand?
- Who else is missing from team?
- Will Founders recruit high caliber people?
- How committed are Founders to the Venture?

Opportunity

Opportunity

A description of the business proposition:

- What it will sell, to whom, how; How fast it can grow, key drivers of success; obstacles to success.
- Fundamentally, an assessment of the size of the market, its growth, and the competition.

Questions about Opportunity

- Who is the customer?
- To what degree is the product or service a compelling purchase?
- How will the pricing be?
- How will the venture reach all the identified market segments?

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Questions about Opportunity (Cont'd)

- How much does it cost (Time and resources) to acquire a customer?
- How much does it cost to produce and deliver the product or service?
- How much does it cost to support a customer?
- How easy is it to retain a customer?

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Opportunity Covers:

1. The Product or Service
2. The Market and Competition
3. Marketing Strategy and Cash Flow
4. The Business Model
5. Staffing Plan
6. Financial Forecasts and Projected Statements
7. Future expansion potential, horizontal, vertical...

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Product/Service

- What are you selling?
- What benefits are your customers buying?
- Which products are rising stars, steady cash cows, in decline (investment egos)?
- What is different about your goods and services?

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Market

- Who buys from you? Define your target markets.
- Are your markets growing, steady, or declining?
- Is your Market share growing, steady, or declining?

Market (Cont.)

- Have you segmented your markets? How?
- Are your markets large enough for expansion?
- How will you attract, hold, and increase your market share?

Market (Cont.)

- Are you planning to enter any new markets?
- How do you price your products?

Competition

- Who are your direct competitors?
- Who are your nearest indirect competitors?
- How are their businesses similar to and different from yours?
- What have you learned from their operations, advertising?

A1-The Product or Service

- Description of what it is, and what for.
- An evaluation of how unique, how differentiated, and how these characteristics represent Value to your customers.
- An assessment of how easily competition could imitate, improve or match your advantage.
- An analysis of the technology used, and of any difficulties that might exist in implementing it.

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A2-Market & Competition (Cont'd)

ii- Market Analysis

- Segmentation.
- Size and rates of growth.
- Consumer buying patterns (seasonality, school start, holidays, etc..).
- Target market share in each segment.

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A2-Market & Competition (Cont'd)

iii-Competition

- Who they are, how large.
- Basis on which they compete:
 - Price
 - Sales volume
 - Design
 - Quality
 - Service
- How does your product compare?
- Can you protect your Unique Features from imitation?

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A2-Market & Competition (Cont'd)

iii-Competition (Cont'd)

- What are the barriers of entry?
- How will competition react? Will it retaliate? How?
- What are the strengths and weaknesses of the competition?

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A3-Marketing Plan

i-Pricing

- What is target price? Is it cost based or demand based? If the price is very different from the current market, why is that?
- 1. Different cost structure?
- 2. Superior product?
- 3. Are you under pricing?

A3-Marketing Plan (Cont'd)

ii-Promotion

- Goals you set to achieve.
- How much you can do at no cost? (Editorials, press coverage...).
- Mix: Advertising, direct mail, Web, trade fairs....

A3-Marketing Plan (Cont'd)

iii-Distribution

- What are the channels?
- What means do you plan to use?
 1. Direct Sales Force
 2. Agents
 3. Commission Reps
 4. Management Team
- 5. What areas will the sales force cover?

A3-Marketing Plan (Cont'd)

iii-Distribution (Cont'd)

6. How large is the incentive structure of sales people?
7. What is their target productivity?
 - Number of calls
 - Conversion of calls to sales
 - Average sales call

B- Cash Flow Drivers

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We Ask:

- When do I have to buy resources?
- When do I have to pay for them?
- How long does it take to acquire a customer?
- How long before the customer send a check?
- How much capital is needed per dollar sales?

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C- Business Models

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Business Models

- Each model has specific characteristics defined by its operating drivers.
- A good business plan must identify these drivers and build an economic model based on them.
- A good business model starts with a limited number of assumptions, and ties them with links that represent the fixed relationship between them. The overall result is a dynamic model of costs and expenses. It is used to test the validity and internal consistency of the business proposition.

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I.S.P. Model

1. Revenue Side
 - \$1 of ad revenue / 1,000 subscriber
 - \$20 of subscription revenue / subscriber / month
 - \$15 / subscriber for initiation
2. Cost side
 - 1 modem / 35 subscribers
 - 1 telephone line / 100 subscribers
 - 64k bandwidth / 250 subscribers
 - 1 help operator / 500 subscribers

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Other Model Measures

- Software design: lines of code / day / programmer
- Restaurants: turnover / seat / sitting
- Super market: gross margin / square meter of shelf
- Airlines: yield / passenger seat / mile

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D- Financial Projections

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From Model to Financials to Cash Flow to Valuation

- A bird's eye view of the financial tools needed:
 - Balance sheet
 - Operating Costs
 - Income Statement
 - Cash Flow
 - Financial projections

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Operating Costs (overhead, fixed, variable)

- Advertising
- Mail
- Tel
- Utilities
- Travel
- Car expenses
- Commissions
- Insurance
- Salaries
- Office supplies
- Dividends

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Non Operating Costs

- Interest
- Amortization
- Depreciation

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Income Statement

- Sales
- Sales Expense
- Net Sales
- C.O.G.S.
- Gross Profit
- Gross Profit Margin

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Income Statement (cont'd)

- | | |
|------------------------------|---------------------------------|
| Controllable (Variable) Exp. | Fixed Expenses |
| ■ Salaries | ■ Rent |
| ■ Payroll related Exp. | ■ Utilities (Fixed portion) |
| ■ Outside Prof. Svces. | ■ Insurance |
| ■ Advertising | ■ Licenses & Permits |
| ■ T&E | ■ Misc. |
| ■ Office Supplies | ■ Operating Profit (EBITDA) |
| ■ Subscriptions/M'ships. | ■ Depreciation (+Amort.) (EBIT) |
| ■ Utilities (Variable part) | ■ Interest Payments |
| ■ Misc. | Total Fixed Expenses |
| Total Controllable | |

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Income Statement (cont'd)

- Net Profit B/Tax (EBT)
- Taxes
- Net Profit A/Tax (E as in P/E)

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Sources And Uses of Cash

- Sources of cash
 - Cash at hand
 - Cash portion of sales
 - Interest earned at bank
 - Sale of assets
 - New loans
 - Capital
- Uses of cash
 - Cash portion to suppliers
 - Interest on loans
 - Acquisition of assets (current or fixed)
 - Settlement of loan and other installments
 - Taxes
 - Operating costs (overhead, fixed, variable)

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Free Cash Flow

$$\begin{aligned} \text{FCF} = & \text{EBIT} \\ & (-) \text{Tax} \\ & + \text{Dep., Amort. \& Non-cash} \\ & \text{charges} \\ & (-) \text{Decrease in Working Capital} \\ & (-) \text{CapEx} \end{aligned}$$

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Pitfalls in Free Cash Flow Projections

- Most businesses cannot grow without a commensurate increase in Working Capital as well as in capital Expenditure.
- Sustainable growth rate.
- Dupont formula.
- Short Life Fixed Assets.

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E-Valuation

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Valuation Methods

- Comparables: (for listed companies, industry competitors)
- **DCF (Discounted Cash Flow)**
- NPV (Net Present Value)
- APV (Adjusted Present Value)
- Option pricing model (*See next 3 slides*)
- Monte Carlo Simulation
- Venture Capital model (*See Handout*)

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Discounted Cash Flow (DCF)

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Variables that Count for DCF

- The Cash Flow
- The Discount Rate
- The so-called Terminal value

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3 - Context

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Context

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4 - Deal

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Deal: Risk and Reward

- An assessment of everything that can go wrong and right, and how the venture can respond.
- The business plan should sketch scenarios, with multiple outcomes depending on the assumptions.
- Taking a snapshot of the future is quite a challenge... except, maybe, for economists?
- The founders should address the major risks, and explain how they would deal with them if they occurred.
- Fundamentally, investors are asked to take a risk, which is hard to measure, in exchange for a profit opportunity, which is even more elusive to define.

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Therefore, exit strategies, (the way an investor recovers his investment plus accruing profits) are an important part of the Business Plan:

- Savvy Entrepreneurs will always try to keep a number of exit options available (Stock Exchange Listing, Buy Out, sell out to larger competitor, sell out to larger integrator firm).
- They will also work hard at keeping these options open as the venture takes its course.

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Sensible Deals

- Sensible Deals share 6 Characteristics:
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Term Sheet Aspects

Definition:

Set of terms and conditions under which Investors will provide capital to fund a Company

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The Executive Summary

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What an Executive Summary is NOT

- An abstract of the Business Plan.
- An Introduction to the Business Plan.
- A preface.
- A random collection of highlights.

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What an Executive Summary Should Achieve

- It should represent a Business Plan in Miniature: .
- Crystallize your thoughts.
- Set Priorities.
- Capture attention and imagination.
- Make readers want to learn more. .
- Convey the flavor of the Plan. .

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Key Elements of a Good Business Plan

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Deal

“**P. O. C. D.**”

Source: Prof. W. Sahlman – Harvard Business School

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10 KEY CHECKPOINTS

1. Focus of Product/Service:

- Proprietary.
- Protectable.
- Sustainable.

2. Weave a Story: Generate enthusiasm

3. Know backgrounds of Investors whom you speak to.

4. Get referrals to introduce you.

5. K.I.S.S. (25 pages max.)

6. Rehearse and have back up answers ready.

7. Know thy competition well.

8. Be real in Financial Projections.

9. Valuation is not a do/die issue

10. Remember that Investors look for an Exit Strategy!

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