SouthWest fd
Financial Management for Growing Businesses

Business plan preparation tips

The ability of a company to plan out its strategy and to provide sound arguments for the probable success of its business will be a key factor in establishing credibility with investors. Above all, the business plan must demonstrate the viability of the business, and be realistic.

Preparing a good plan can be time-consuming. Considerable care should go into its preparation. However, it is time worth spending as a well-presented plan will immediately create the right impression.

What follows is a series of tips on what to include in the detailed plan. Every plan will be different, however, and the guidance set out below will need to be adapted to your particular business. Also, while we use the term 'investor' in the main, this applies to anyone who may fund the company, including venture capitalists and bankers.

Suitability of a company for private equity funding

Equity investors will essentially be looking for the following:

- Companies with a potential for high growth. "Lifestyle" businesses will not be suitable. At a minimum you can expect investors to want to double their money over three years. The potential for this level of growth will need to be demonstrated.
- Investors will want a fair proportion of the equity for their money. Debt, finance leases or redeemable preference shares can sometimes be used as a means to provide the cash from investors you need while keeping the equity you part with to the desired level. However you do not state the valuation of the company or what % equity you are selling for the funding – this is for later negotiation.
- A personal relationship. Investors will want to monitor their investment as a minimum. Some may want a seat on the board. Private investors may even be able to fill a skills gap and become involved in the management of the company (but at the same time might be looking for income in the form of a salary or a consultancy fee).
- Evidence that you have a strong understanding of your products and services and your market. Some investors like to see your business occupy a market leading position or require a description of those factors which make it difficult for others to enter or succeed in your market ('barriers to entry'). If your business is a start up, the business plan should be based on sound and convincing market research.
- An experienced and professional management team. Product and sales skills will be especially important. Other missing skills can perhaps be addressed by the new funding, but should be identified. Much may depend on your target investor. Lack of management skills may be a concern for institutional investors but may be seen by a private investor as an opportunity to become more closely involved with the business.

- Commitment. Investors will look to see how much of your own money you have invested, the extent to which your remuneration is linked to the success of the business and whether you have outside business interests which could affect your dedication to the company.

- An exit. Investors will not wish to be locked into an unquoted investment forever. Many will look for a realisation within five years. Exits can take the form of a trade sale, a flotation (for a larger company), a buy-back by the company, a sale to the other shareholders or a new investor or possibly a management buy-out. An analysis of your marketplace and the likely acquirers of your business is important (e.g. your market may be fragmented which will lead to an expectation of consolidation and therefore provide ready purchaser candidates).

The business plan should address all the above issues. It is always a good idea as part of the business plan preparation to carry out a legal audit of your business to ensure that you have all your paperwork up to date (e.g. customer relationships or joint ventures recorded in a legal document), your corporate records accurately describing the status of your company and any licences you require to carry on your business being in place. All these matters will be looked at in detail by an investor and it will create a bad impression of your business for these matters to come to light during the due diligence process.

Your own work

While there is nothing wrong in using a professional adviser to discuss the preparation of a business plan, it should essentially be written by the company. An experienced investor will soon see through a business plan that is not the company's own work.

Sensitive information

We suggest you do not include information that is commercially sensitive. Although most potential investors will behave responsibly, there is always a possibility that a copy of the plan could end up in the wrong hands (a competitor for example). Recipients of the plan should be asked to sign a confidentiality agreement in advance.

Style

The business plan should:

- be concise (the main part of the plan should ideally be no longer than 30 pages with the detail relegated to appendices)

- contain an executive summary

- have a contents list so that relevant sections can easily be located

- have a readable font size (we like Arial 10 point and 1.5 line spacing)

- avoid the use of jargon or overly technical terms (or at least explain clearly what these mean)

- be regularly updated (with a fresh issue date) to avoid it looking stale in the hands of new recipients

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- be free of errors (spelling errors, for example, often leave a bad impression)

Contact details

Include contact details in a prominent position. Give names, addresses, e-mail addresses, telephone and fax numbers. Include your web site address if you have one.

Executive summary

This should be incorporated at the beginning of the plan. It will be a key section. It will create the first impression and often will determine whether an investor/banker will bother to read the whole plan. It should give sufficient information to enable the reader to decide whether your business is going to meet that person's investment objectives. It should not be long, ideally 2 to 3 pages, and in punchy short paragraphs.

It should provide a summary of the following:

- Purpose of the plan.
- The business of the company and its USPs.
- Its market (customer type and geographical spread).
- Its history and how long it has been established.
- Its present ownership.
- Current trading and prospects.
- Background of the management team.
- The finance required, when it will be needed and what it will be used for.
- Exit strategy
- Brief P&L projections

History and background

You should give details of the following:

- When the business was started and by whom.
- The reasons for starting it.
- Operating location. Give details of any lease commitments.
- Any past or present problems and how they were dealt with or will be dealt with.
- Any specific successes.
- Industry overview

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- The present owners, including how much they invested and what management role they have in the business.
- Any changes in ownership.

If your business is a start-up, you should explain what has brought it about, the progress made to date and your proposals in relation to the above so far as they are relevant.

Products and services

This section of the plan should describe:

- The business of the company and what it does.
- What differentiates the business.
- The operational activities involved in the business.
- The changes that are likely to affect the business over the next few years.
- How the business intends to respond to these changes.
- Any intellectual property rights held by the business (patents, copyright, licences etc) and how dependent the business is upon these.
- Whether sub-contractors are used. Identify why you do this and who they are.
- Dependence on key suppliers and whether they can be replaced if necessary.
- What strains the projected growth of the business will place on the above and how these pressures will be resolved.
- Any known legal issues affecting or likely to affect the business and how you intend to address these.
- After sales and warranty liabilities, or other contingent liabilities.
- Your insurance cover.

Future strategy

In this section you should outline your future plans for the company. This should demonstrate the viability of the business and set out how you anticipate achieving the levels of growth that will be expected by an investor. You should particularly concentrate on future profitability. It will be important to demonstrate that a market exists for your products or services and that future sales are based on sound assumptions rather than optimistic estimates. An investor will not invest unless he is convinced that your company has a profitable future.

You should remember that an investor will usually seek a legal undertaking that the company will not materially change the nature of its business as described in the business plan. You should therefore make sure that the business plan adequately sets out your future proposals.

The Market

Your business plan MUST demonstrate, almost above all else:

a) That a market exists for the product or service you intend to provide and

b) That you can sell to that market place profitably.

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In most business plans the aspect that is least researched and most scantily covered is the question of the marketplace. In many business plans you will see excellent analyses of cost of production, distribution, promotion etc, but forecasts for sales that might just as well have been pulled from a hat.

It is absolutely vital that the sales forecasts are based on more than just an optimistic guesstimate. If the sales cannot be made, then there is absolutely no question of being able to make the profit and without the profit there will be no capital gain and no income to distribute. In short, you will not have a project that invites investment.

You should describe:

- Your market and, if it is a niche market, what distinguishes it.
- Any available external data concerning your market and its size.
- How you currently sell to your market profitably or how you expect to do so in the future.
- The sectors your customers are in.
- The geographic/demographic spread of your customers.
- Your major customers and how long they have been with you. Investors will be particularly interested in profitable orders from blue chip customers.
- Your dependence on major customers.
- Dependence upon any personal relationships involving key customers.
- How you retain existing customers.
- How you monitor relations with your existing customers.
- How you win new business.
- Your key success factors - USPs (e.g. a patent, product superiority or uniqueness, superior customer service, market niche etc).
- How potential customers find out about you.
- Your key target customers.
- Your marketing and advertising strategy. Your budgets for this.
- Your sales and marketing personnel. Who they are and how they are organised.
- Your competitors. Who they are and why you are different.
- How you will stay different.
- Any barriers to entry to your market.
- Where the competitive threats are likely to come from in the future.

Team

Above all, investors will invest in your company because they have confidence in the management team. This section should emphasise the strengths and accomplishments of the management team and should include the following:

- Brief profiles of the directors, including non-executives, and key managers (summary CVs should appear in an appendix).
- Qualifications.
- Their ages and roles.
- Their track records and previous achievements.
- Length of service.
- Their service contract details (current remuneration and benefits, notice periods, restrictive covenants, time devoted to the business etc). Investors will look to see how closely personal earnings are linked to the success of the business.

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- Share options held, and proposed to be held.
- Any outside business interests.
- The workforce (numbers and the mix between full time, part time, employees, freelancers, out workers etc).
- How skilled the workforce is required to be.
- Dependence on key managers/skilled workers.

Problems in a director's or manager's past (e.g. a personal bankruptcy, involvement with an insolvent company, disqualification as a director, criticism by a regulatory authority or criminal proceedings) should be dealt with in an up front manner. Due diligence will normally uncover anything untoward (for example, you can expect investors to take up references on the key management). Investors will look for reassurance that the circumstances were exceptional, down to misfortune or that lessons have been learned and a recurrence is highly unlikely.

Operating plan

This section can include items such as systems and controls, logistics, premises that are not included elsewhere. Investors know that young growing companies can often have inadequate operating systems and financial controls. You should explain what you have done in this area and who is responsible for this aspect of the company's business. Investors will want reassurance that they will receive regular and accurate financial information relating to the company's business. You should discuss these issues with your auditors and follow their recommendations. They will then be able to help you give appropriate comfort to investors.

Financial information

This part of the plan should contain the financial highlights with the detailed information set out in an appendix. It should show:

- The historic performance of the company since it was incorporated, showing year-on-year growth. Provide explanations of key movements in numbers.
- The company's profit and loss, balance sheet and cash flow forecasts for the next five years. If the profit projections are substantially better than past profits you should explain why you believe this will be the case (investors will look critically at this). Monthly forecasts for the first three years and annual forecasts for the next two years should be sufficient. The cash flow forecast should particularly focus on the cash requirements of the company for the first twelve months following the proposed investment. Although five years' projections sounds like you need a crystal ball, if the numbers are based on robust and credible assumptions then they are possible to produce, and are required for a proper valuation of the company.
- An explanation of the assumptions upon which the forecasts are based and your justification for them.
- A break even analysis, to demonstrate the level of turnover it will take for the company to achieve profitability or, if it is already profitable, how much turnover would need to fall before the company becomes loss-making.
- A pro-forma balance sheet showing the anticipated capital structure of the company following the investment.

Risk analysis

Investing in a young growing company is always a risky matter. Assumptions and forecasts can prove to be wrong. The unexpected may happen. Legislation affecting the company may change.

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There may be transactional and operational risks. The company may be reliant on certain key customers or sources of supply. New competitors may emerge. There is unlikely to be a ready market in the shares of the company. You should set out in the business plan what you see as the main risk factors involved in making an investment in your company and how these might be mitigated should things go wrong. This will demonstrate that you have thought things through from the investor's perspective and will undoubtedly help with investor relations if the unexpected does happen.

It is a good idea to show a SWOT analysis, which will also help to identify risks.

Current status

You should give details of the following:

- the company's directors
- any proposed directors
- the secretary
- the registered office
- the company's principal place(s) of business
- the issued share capital
- the existing shareholders
- You should also includes details of the company's advisers (e.g. auditors, solicitors, bankers, insurance brokers etc) giving addresses, contact names and telephone numbers. An accomplished set of advisers will help to give the business credibility.

Finance required and use of funds

You should give details of:

- The total amount of funding required (if there is a minimum and a maximum funding requirement, this should be explained).
- When the funding is required. You should explain whether the funding could be phased, tying this to the peak cash requirements shown in your cash flow forecasts.
- Existing borrowings and borrowing facilities, or other financial facilities (e.g. factoring arrangements). Are there any loans from shareholders or directors? Is it intended that these will be capitalised?
- Any proposed new borrowing facilities or other financial facilities. The new equity funding will improve gearing and may well open up opportunities to obtain further loan finance.
- What security can be offered? Is it intended that the new investors will be invited to lend money to the company?
- Any grants that will or have been made available to the company.
- The use to which the new money will be put. You should go into some detail on this.

Highlight any specific help the business needs. Investors will normally wish to see the funds being used to help to grow the business and not, for example, to repay shareholder or bank loans, buy out dissenting shareholders, resolve disputes, increase executive remuneration, pay dividends etc.

The deal for the investor

Once the investor has seen the plan, the main focus of negotiations between the company and potential investors will be on the percentage of equity to be offered and the price to be paid for

that equity. There is always room for a difference of opinion on this issue but you should show how you have valued the company and your justification for this valuation. However in our opinion this is NOT laid out in the plan, or it could compromise subsequent negotiations and put you in a corner.

As well as this, you should describe the other principal issues affecting potential investors including:

- The proposed exit route for the investor. As mentioned earlier, investors will not wish to be locked into an unquoted investment forever and most will be looking to realise their investment within five years. The exit route will normally take the form of a trade sale, a flotation (for a larger company), a buy-back by the company, a sale to the other shareholders or a new investor or possibly a management buy-out. You should explain who you think the anticipated buyers might be and whether any offers or expressions of interest have been received in the past and why they were turned down. A management buy-out might be attractive if cash flows permit because it is likely to involve fewer liabilities in the future (typically warranties and indemnities are minimal) but a competent, independent management team must be developed as part of this strategy.
- Will the company qualify for any available tax reliefs for the investor, for example under the Enterprise Investment Scheme (EIS) or as a Venture Capital Trust (VCT)? We can advise you separately on this.
- What share options are proposed for directors and employees? While the investor will often agree that the workforce should be incentivised, he will not wish to see abnormal dilution. Typically, option grants will be limited to 10% of the enlarged issued share capital. The exercise price and the exercise period will be a matter for negotiation. Often investors will not wish to see the exercise price for new options set below the price per share paid by them and the longer the exercise period the more dilutive it will appear to investors and the less of an incentive for the workforce to grow the value of the company quickly.

Other points that may be mentioned include:

- Whether you want a single investor or a syndicate of investors (spreading the risk across a number of investors might be more feasible where you wish to raise a relatively large amount and may also avoid any single investor acquiring a strategic blocking stake in the company).
- Any finance to be offered in the form of loans or redeemable preference shares. These may help to top up the overall funding requirement if you do not wish to give away too much of the equity or if the price of the equity is negotiated downwards.
- Any security that can be offered for loans.
- The anticipated schedule for repayment of loans or preference share capital. This should be built into your cash flow forecasts.
- Any active participation for the investor. Is it intended he or she will be or be entitled to appoint a non-executive director or, possibly, an “observer” at board meetings (to monitor the investment but to avoid the liabilities of a director)? Are any special skills, experience or contacts an advantage? Could a suitable private investor fill a skills gap? If so, these should be explained. Is a consultancy appropriate? How many days a month would be expected?
- Can your company afford to pay an appropriate salary or consultancy fee.
- Control over the withdrawal of funds from the company in the form of salaries, fees and dividends.

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- Any proportion of the equity that is being reserved for second-round finance. Explain the likely time scale for this.
- Whether you propose to effect “key person” life assurance for key directors or managers to protect the company and the amount of the proposed cover.

Legal issues

There are specific legal requirements relating to the distribution of business plans. It is unlawful to distribute a business plan to anyone unless certain specific requirements are met in order to comply with investor protection legislation. Particular care should be taken with investors who are private individuals. Moreover, a business plan should not be distributed too widely in order to avoid a company being deemed to have issued a prospectus unlawfully. A special legal “health warning” should appear prominently in the plan.

It should be remembered that an investor will often ask the directors to warrant the accuracy of the final version of the business plan. In the case of financial projections, it is common to be asked to warrant that these have been prepared with due care and on a reasonable basis. Avoid over-stating your case. An overly optimistic business plan may cause considerable embarrassment later if it has to be toned down to a form that can be warranted.

The audience

In composing the plan you need to consider the ways in which the needs of the private investor differ from those of the venture capitalists and banks.

Bank managers and venture capitalists rarely wish to take a hands-on, active role in the management of the business. However many informal private equity investors wish to be directly involved in the business. In the case of a private investor it may be useful to emphasise what skills are lacking or need to be reinforced, and could be provided by the investor and to what degree.

Equally, if admitting to a gap in management skill you must be able to show how it will be filled if the investor cannot or will not carry out the function. This would normally be in the form of including an overhead for a consultant, which the prospective investor could regard as being his own fee if he becomes directly involved at that level rather than as a director. Alternatively make it clear that the funding is required in part to recruit the missing skills.

Bank managers are invariably looking for income stream sufficient to service interest and repay loans that they have made to the business. By contrast venture capitalists are rarely looking for such an income stream but rather for high capital appreciation. The private investor may fall into either or indeed both categories. Thus, he may be satisfied with dividend income on an ongoing long-term basis.

In the alternative, like venture capitalists, they may wish to see large capital appreciation. As indicated above, they may wish to be involved with the management of the company and therefore are actually looking to receive a direct income in terms of salary or consultancy fees. If the plan cannot accommodate the paying of salaries, fees or dividend then state this clearly in the plan.

Main problems with Business Plans

- Quality of team questionable
- Vision/strategy unclear or not well articulated

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- Too many facts, not enough analysis
- Lack of commercial reality
- Lack of credibility in financial projections
- No real customer need or benefit established / lack of USP – Too ‘ME TOO’
- Too complicated
- Insufficient growth potential
- Route to market unclear / vague on market drivers
- Insufficient evidence of demand
- Competition complacency and not properly identified
- Lack of contingency planning
- Assumptions are fuzzy
- Unclear on need and level of funding
- Exit not well defined

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