

Thoughts on Business Plans

1

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Internet Wicked Ale

- Internet Wicked Ale, Inc. (IWA), an interactive, on-line marketing company is formed to sell premium beers made by microbreweries over the Internet.
- According to the president of the company -- a soon-to-graduate MBA candidate at a well known eastern business school -- a prototype web site had already been developed using the Java programming language.
- Participating in the meeting were two other MBA candidates. Prior to jointly founding IWA, the three had worked in management consulting and investment banking: each, however, did have substantial experience with beer.
- Based on the business plans, each proposing to “revolutionize” an industry, each “conservatively” projecting at least \$50 million in revenues within five years based on a modest market share of under 10%, and each containing a projection of likely investor returns of over 100% per annum.
- They looked so young - they were so enthusiastic – their business plan was so meticulously printed on the new color laser printers in the technology lab

2

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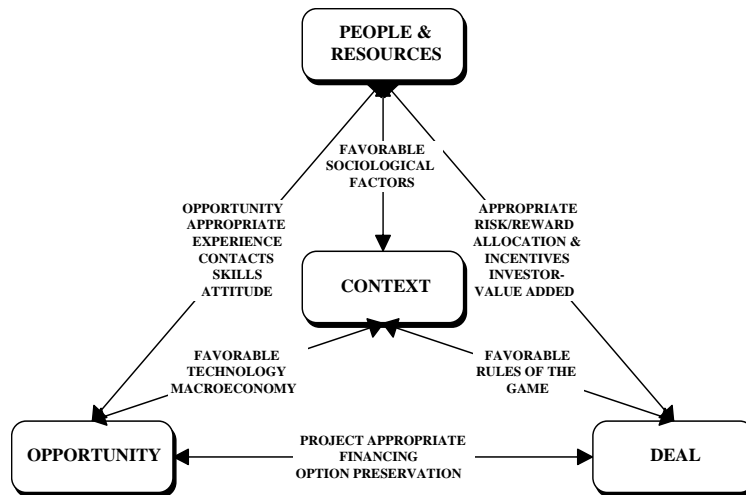
Entrepreneurship

- Working definition:
The relentless pursuit of opportunity without regard to tangible resources currently controlled
- A complete process from identification to harvesting
- A way of managing

The Structural Model

- The critical elements
 - ◆ People
 - ◆ Opportunity
 - ◆ Context
 - ◆ Deal
- The concept of FIT
- The concept of dynamic FIT Management

The Concept of FIT



5

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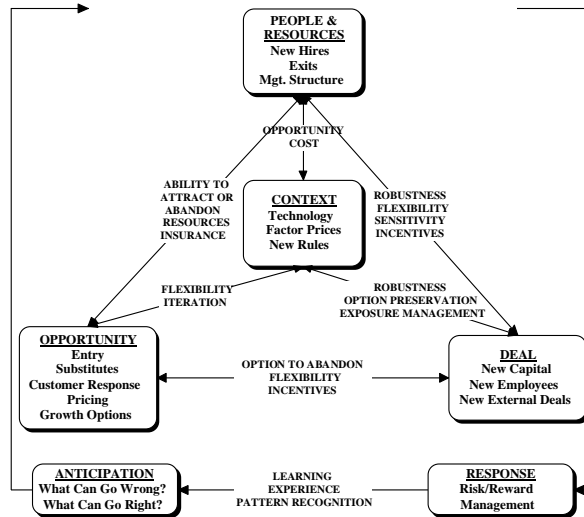
The Concept of FIT The Answer to Four Questions

- To what degree do the people have the right experience, skills and attitudes, given the nature of the opportunity, the context and the deals struck?
- To what degree does the opportunity make sense, given the people involved, the context and the deals struck?
- To what degree do the deals involved in the venture make sense, given the people involved, the nature of the opportunity and the context?
- To what degree is the context favorable, given the people involved, the nature of the opportunity and the deals struck?

6

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Dynamic FIT Management CHANGE (GOOD AND BAD NEWS)



7

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The Entrepreneurial Manager Continuous Experimentation and Learning



Identify - Marshal - Act/Exploit - Harvest

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People Questions

- What have the founders done in the past that would lead you to believe they will succeed in the future?
 - ◆ Experience
 - ◆ Contacts
 - ◆ Reputation
 - ◆ Skills
 - ◆ Integrity
 - ◆ Attitude
- Successful venture founders have two characteristics:
 - ◆ They are “known” and they “know.”
- Who is missing and how will they be recruited?
- Arthur Rock, a venture capital legend stated bluntly, “I invest in people, not ideas.”

9

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Opportunity Questions

- How big is the total market?
- How much consumer value can be created?
- How much producer value can be created and captured?
- What are the implications of entry on the size of the pie?

10

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Essential Questions Related to Opportunities

- Who is the customer?
- How do they make decisions?
- What risks do they perceive? What benefits?
- To what degree is the product or service compelling?
- How will the product or service be priced?
- How will the venture reach target segments?
- How much does it cost (money and time) to acquire a customer?
- How much does it cost (money and time) to produce and deliver the product or service?
- How much does it cost to support and retain a customer?
- What is the lifetime value of a customer?

Buy low, sell high, collect early, and pay late.

Opportunity Sources

- Pipeline strategy -- Intuit
- Ammunition strategy -- Abacus Direct.
- Razors and razor blades strategy-- Gillette
- Arbitrage strategy -- MCI

Industry and Competitive Analysis

- The five forces
- The choice of a strategy
- Opportunity duration
- Interactions of capital and product markets
- Ways to change the basis of competition
- Perspective of the new entrant (war games)

13

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Business Model Analysis

- The “tracks” of the model are in the income statement and balance sheet

Income Statement

Sales
COGS
SG&A Fixed vs. Variable costs?
Interest
Taxes
Depreciation

Balance Sheet

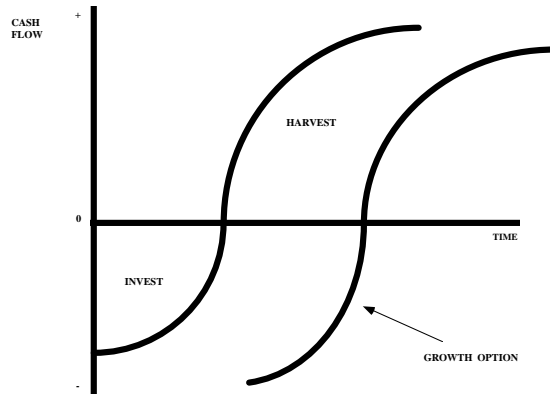
A/R	A/P
Inventory	Debt
NPPE	Equity

- What can be reengineered? By your company? By a new entrant?
- Examples: can I get paid earlier? can I go direct? can I produce JIT?

14

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Free Cash Flow Patterns

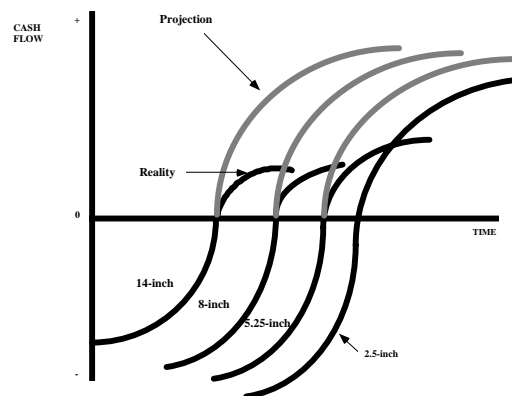


A growth option is an opportunity to invest that results from being in a particular business (e.g., the ability to introduce a new product or service to existing customers).

15

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The Disk Drive Business Disruptive Technologies



Issues :

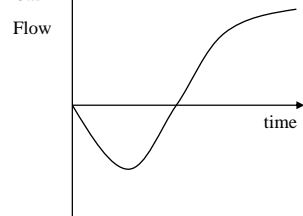
Relationships between curves
Consequences of missing a curve

16

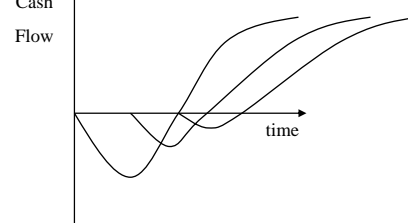
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Patterns

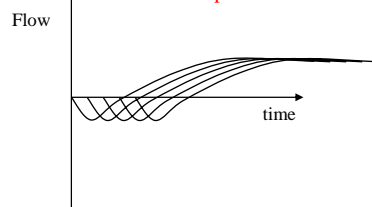
Cash Flow **Simple project, no growth options**



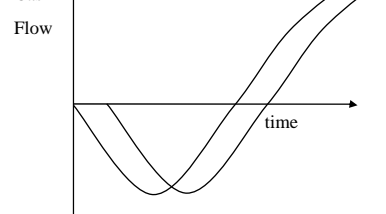
Cash Flow **Growth options**



Cash Flow **Clone options**



Cash Flow **Uncorrelated options**



17

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Curve Questions

- What are the milestones?
- How long does it take to reach each milestone?
- How much does it cost to reach each milestone?
- Uncertainty of payoff structure?
- What are the options created or destroyed at each milestone?
- What is the relationship between curves?

18

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Contextual Pressures

- Heightened uncertainty
- Global and domestic competition
- The entrepreneurial revolution
- Capital market pressures

Deals

- Fundamental premise:
 - ◆ People act in their own (perceived) best interest
- How is cash allocated?
- How is risk allocated?
- What are the incentives?
- What can be inferred by decisions?
- What are the future (micro and macro) consequences of current decisions?

From whom you raise capital is often more important than the terms.

Critical Steps in Deal Structuring and Analysis

- Complete list and assessment of the players
- Complete “what if” analysis
- Complete analysis of incentives
- Sensitivity to sequencing (path matters!)

Good Deals

- Simplicity
- Fairness
- Trust
- Robustness
- The passage of time
- Improving the chances of success
- Decreasing the risk or consequences of failure

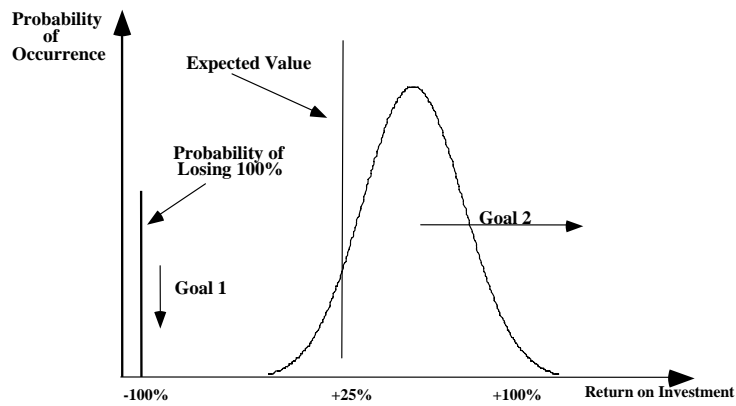
Negotiations

- Ranges of reasonable values
- Understanding the key factors that affect risk and reward (where to give in and where not to)
- Creating perception of overlap
- Negotiating skills
- Using external events to advantage
- Turning adversaries into partners
- Resolving impasses

Risk/Reward Analysis and Management

- What can go wrong?
- What can go right?
- What decisions can management make today and in the future to ensure that “what can go right” does go right and “what can go wrong” is avoided, or failing that, is prevented from critically damaging the company?
- Structuring the analysis:
 - ◆ People
 - ◆ Opportunity
 - ◆ Context
 - ◆ Deal

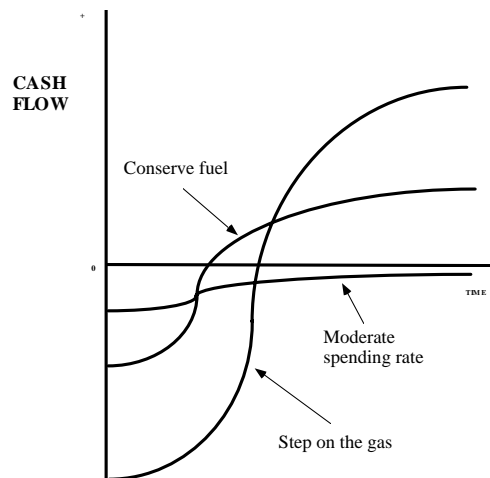
Risk/Reward Management



25

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Free Cash Flow and The Choice of Burn Rates



26

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Outline of Business Plan

- Outline of Business Plan
 - ◆ A suggested outline of a business plan is shown on the next several slides.
 - ◆ Most business plans do not include all the elements introduced in the sample plan; we include them here for the purpose of completeness.
 - ◆ Each entrepreneur must decide which elements to include in his or her plan.

Exploring Each Section of the Plan

- Cover Page and Table of Contents
 - ◆ The cover page should include the name of the company, its address, its phone number, the date, and contact information for the lead entrepreneur.
- The Executive Summary
 - ◆ The executive summary is a short overview of the entire business plan; it provides a busy reader with everything that needs to be known about the new venture's distinctive nature.
 - In many instances, an investor will first ask for a copy of the executive summary and will request a copy of the full business plan only if the executive summary is sufficiently convincing.

Exploring Each Section of the Plan

- The Business
 - ◆ The most effective way to introduce the business is to describe the opportunity the entrepreneur has identified— that is, the problem to solve or the need to be filled—and then describe how the business plans to address the issue.
 - ◆ The description of the opportunity should be followed by a brief history of the company, along with the company’s mission statement and objectives.
 - ◆ An explanation of the company’s competitive advantage and a brief description of the business model follow.

Exploring Each Section of the Plan

- Management Team
 - ◆ As mentioned earlier, one of the most important things investors want to see when reviewing the viability of new ventures is the strength of its management team.
 - ◆ If the team doesn’t “pass muster,” most investors won’t read further.
 - ◆ The material in this section should include a brief summary of the qualifications of each member of the management team, including his or her relevant employment and professional experiences, significant accomplishments, and educational background.

Exploring Each Section of the Plan

- **Company Structure, Ownership, and Intellectual Property**
 - ◆ This section should begin by describing the structure of the new venture, including the reporting relationships among the top management team members.
 - ◆ The next part of the section should explain how the firm is legally structured.
 - ◆ The third part of this section should discuss the intellectual property the firm owns, including patents, trademarks, and copyrights.

Exploring Each Section of the Plan

- **Industry Analysis**
 - ◆ This section should begin by discussing the major trends in the industry in which the firm intends to compete along with important characteristics of the industry, such as its size, attractiveness, and profit potential.
 - ◆ This section should also discuss how the firm will diminish or sidestep the forces that suppress its industry's profitability.
 - ◆ The firm's target market should be discussed next, along with an analysis of how it will compete in that market.

Exploring Each Section of the Plan

- Marketing Plan

- ◆ This marketing plan should immediately follow the industry analysis and should provide details about the new firm's products or services.
- ◆ After reading this section of the plan, an investor should be confident that the firm's overall approach to its target market and its product strategy, pricing strategy, channels of distribution, and promotional strategy are in sync with one another and make sense.

Exploring Each Section of the Plan

- Operations Plan

- ◆ This section of the plan deals with the day-to-day operations of the company.
- ◆ An overview of the manufacturing plan (or service delivery plan) should be followed by a description of the network of suppliers, business partners, and service providers that will be necessary to build the product or produce the service the firm will sell.
- ◆ Any risks or regulations pertaining to the operations of the firm should be disclosed, such as nonroutine regulations regarding waste disposal and worker safety.

Exploring Each Section of the Plan

- Financial Plan
 - ◆ The financial section of the plan must demonstrate the financial viability of the business. A careful reader of the plan will scrutinize this section.
 - ◆ The financial plan should begin with an explanation of the funding that will be needed by the business during the next three to five years along with an explanation of how the funds will be used.
 - This information is called a sources and uses of funds statement.
 - ◆ The next portion of this section includes financial projections, which are intended to further demonstrate the financial viability of the business.

Exploring Each Section of the Plan

- Financial Plan (*continued*)
 - ◆ The financial projections should include three to five years of pro forma income statements, balance sheets, and statements of cash flows.
 - ◆ It is important to remember that the business plan should be based on realistic projections.
 - If it is not and the company gets funding or financing, there will most certainly be a day of reckoning. Investors and bankers hold entrepreneurs accountable for the numbers in their projections.

Exploring Each Section of the Plan

- Critical Risk Factors
 - ◆ Although a variety of potential critical risks may exist, a business should tailor this section to depict its truly critical risks.
- Appendix
 - ◆ Any material that does not easily fit into the body of a business plan should appear in an appendix. Examples of materials that might appear in the appendix include:
 - Resumes of the top management team members, photos or diagrams of product or product prototypes, certain financial data, and market research projections.

Putting It All Together

Is the business just an idea, or is it an opportunity with real potential?

Does the firm have an exciting and sensible business model? Will other firms be able to easily copy it?

Is the product or service viable? Does it add significant value to the customer? Was a feasibility analysis completed?

Is the industry in which the product or service will be competing growing, stable, or declining?

Does the firm have a well-defined target market?

Putting It All Together

Is the management team experienced, skilled, and up to the task of launching the new firm?

Is the firm organized in an appropriate manner? Are its strategy and business practices legal and ethical?

Are the financial projections realistic, and do they project a bright future for the firm? What rate of return can investors expect?

How will the firm's competitors react to its entrance into their markets?

What are the critical risks surrounding the business, and does the management team have contingency plans in place if risks become actual problems?

Presenting the Business Plan to Investors

Ten PowerPoint Slides to Include in an Investor Presentation

1. Title slide
2. Problem
3. Solution
4. Business model
5. Management team
6. Industry and target market
7. Competition
8. Intellectual property
9. Financial projections
10. Current status, amount of money requested, and projected use of funds