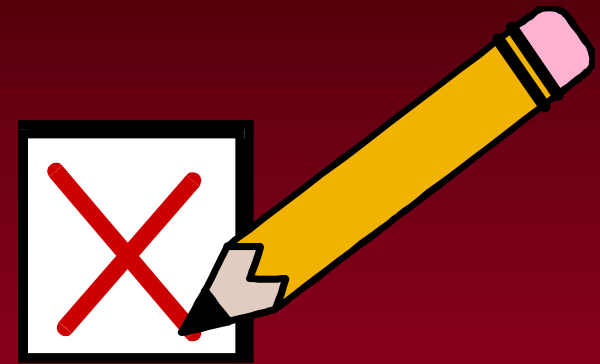


Basics of Business Plans



Adapted by Carlos F. Ostertag
Rural Agroenterprise Development Project
CIAT
May 2001

Introduction

- **All enterprises should have a business plan for each business unit**
- **Plans can be for either new or existing business units**
- **The business plan serves as a framework or guide that must be updated periodically**
- **Financial agencies require a business plan**
- **Helps identify key questions that an entrepreneur should be able to answer**



Why have a business plan?

(T. L. Dixon - Technoserve Tanzania)



- Demands research and analysis to measure the opportunity and risks
- Unites the team in a common direction
- Identifies gaps in strategy; discarding some courses of action in favor of others
- Identifies the resources needed to get there
- Provides performance benchmarks over time
- Serves as a communication tool to attract funding and support

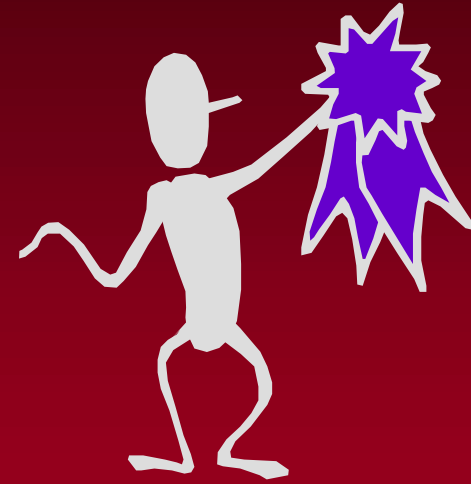
General Structure



- **Executive summary**
- **General vision of the enterprise**
- **Marketing plan**
- **Initial capital requirements**
- **Financial projections**
- **Annexes**

Executive summary

- It should be the last section you write
- It's the business plan in miniature
- Must be clear, concise and interesting
- Includes:
 - the business idea
 - the target market
 - distribution channels
 - competitive advantages
 - projected growth rate
 - estimated investment need & funding sources
 - internal rate of return estimate
 - opportunities & risks



General Vision - 1



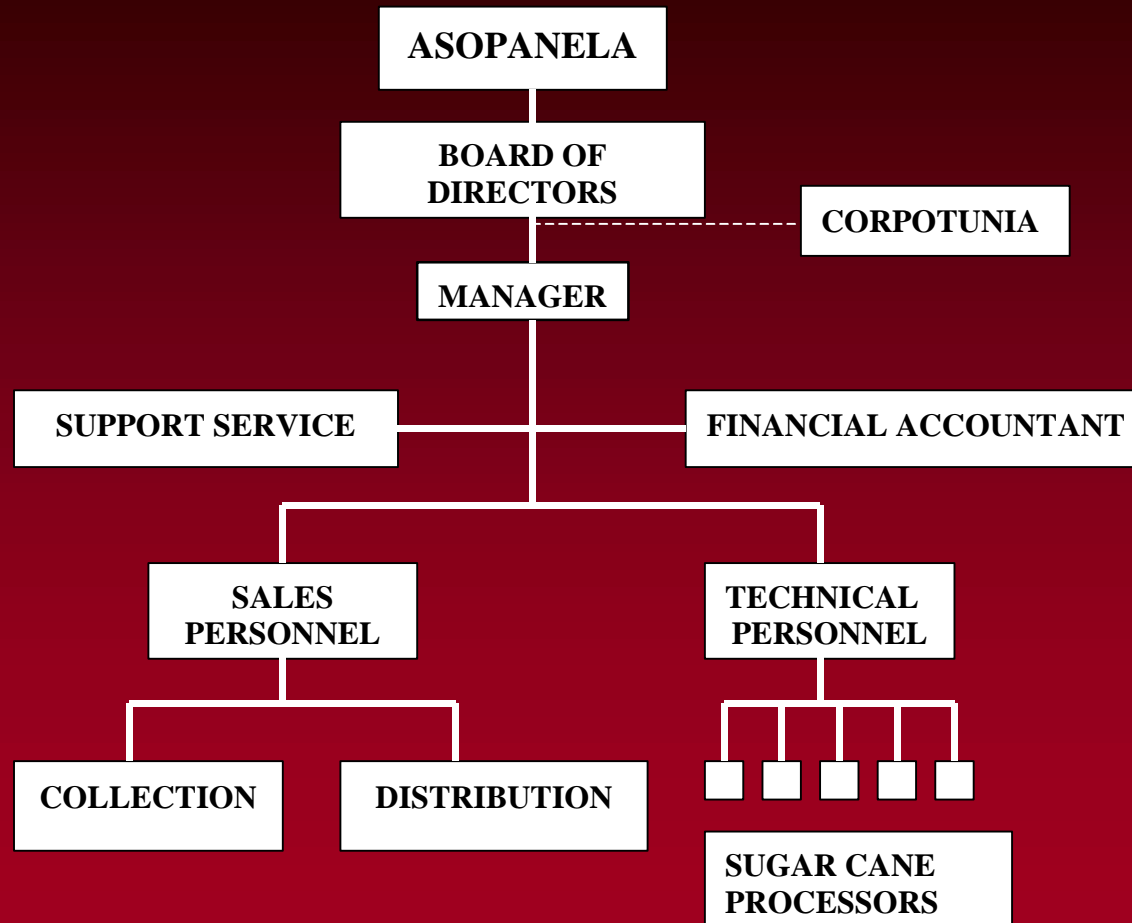
- **Business strategy**
General approach of the enterprise to market its products and services and a description of the past, present and future
- **Identification of the market opportunity**
Brief description of the market in terms of client needs
- **Business objectives**
What is the dream? Why is the enterprise going to be started?
- **Legal format of the organization**
sole proprietorship, partnership, association, corporation, etc.

General Vision - 2

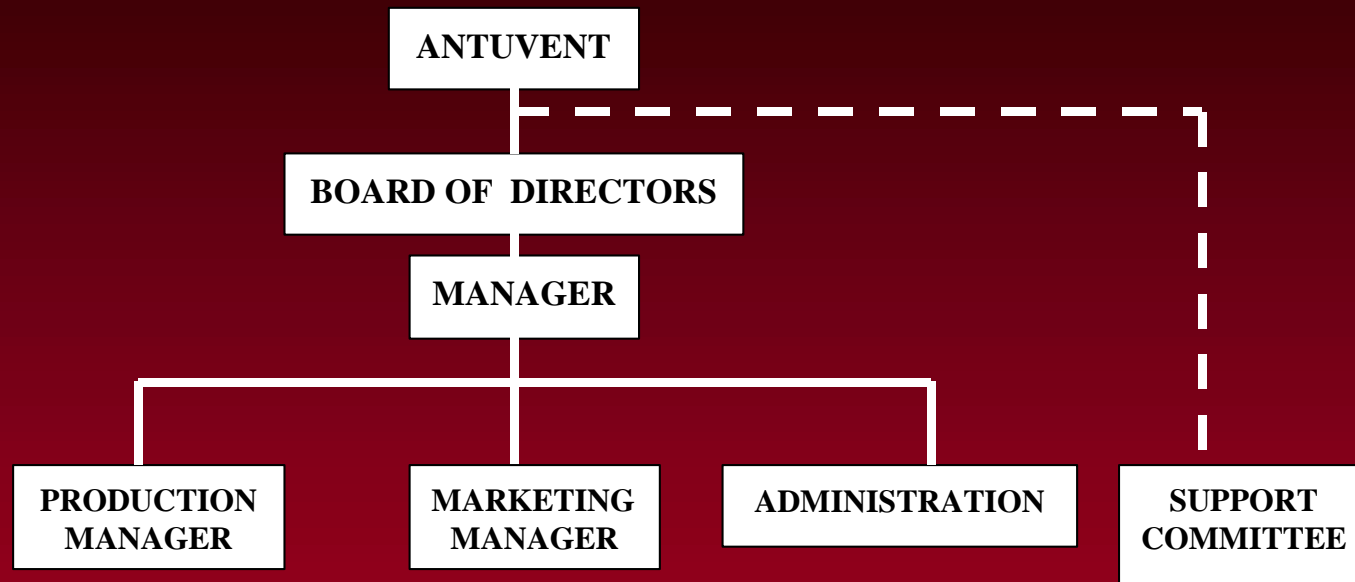


- **The management team & organizational chart**
 - **who will be in charge of the business, what will be the strategic processes and/or functions of the operation, why will they be able to contribute to success**
 - **organizational chart with a description**
 - **positions and salaries**
 - **management team**
 - **Board of Directors/Advisory board**
 - **short profiles of main actors**

Organizational chart



Organizational chart



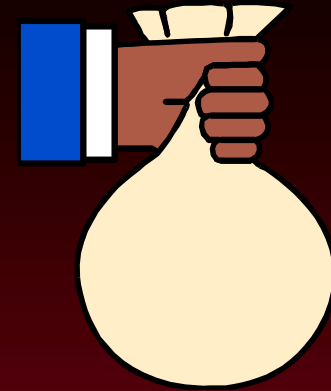
* The Support Committee accompanies marketing personnel

General Vision - 3



- **Description of markets & business location**
 - **This is an intro to the Marketing Plan**
 - **Description of the market opportunity & goods and services to be offered**
 - **Types of clients that will be attracted**
 - **The geographical area to be served**
 - **The number of facilities**
 - **Is a franchise, or exclusive rights to a brand involved?**
 - **Anticipated competitive advantages**

General Vision - 4



- **Financing the business**
 - **Must inform of the capital required to start the business or project and how this will be obtained**
 - **Summary of the financial statements for the first year of operations**
 - **Balance sheet, Income statement and Cash flow**

Visión General - 5

- **Timetable for execution**
 - **For new enterprises or projects**
 - **Problems and details have to be anticipated**
 - **Murphy's Law: "If something can fail, it will"**
 - **define capacity and location**
 - **define market location**
 - **purchase machinery**
 - **identify suppliers**
 - **contract personnel**
 - **design advertising**
 - **define opening date**

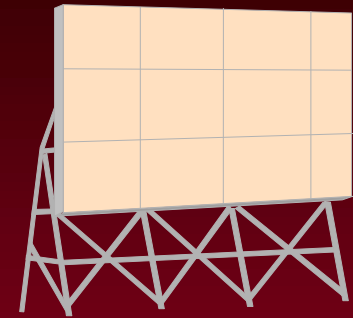


Simple Timetable/Gantt Chart

Activity	Week/Month					Responsible
	1	2	3	4	5	
	X					
		X				
			X			
				X		
				X	X	

Marketing Plan

- Explains how the enterprise will create and maintain its clients for a profit
- Describes the industry, market, competition, potential clients, and marketing mix
- The marketing mix are the four P's (Product, Price, Place or Distribution & Promotion)
- The enterprise should offer products that are new or better than those of the competition
- Presentation on Marketing Plans



Initial capital requirement - 1

- Lack of capital is the second most important cause of business failure
- Cash requirements are generally underestimated
- Funds are required for survival during the first months
- Buy new or used, for cash or on credit, lease better?
- There are three types of capital:
 - working capital
 - capital for growth
 - permanent capital



Initial capital requirement - 2

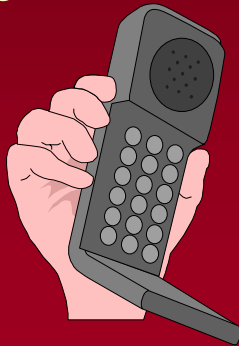
- Calculate first-year sales based on:
 - experience and knowledge
 - market research, key informants
 - as a % of global sales in the industry or category (market share)
- Do clients come from the competition or are they new?
- Use format to “Calculate Capital Requirements”



Initial capital requirement - 3

Monthly expenses

- salaries/wages
- rent
- utilities
- communications
- advertising
- raw materials
- supplies
- taxes
- maintenance
- interest
- consultancies
- others



Starting costs (once)

- construction
- equipment & installation
- furniture
- tools
- initial inventory(products or inputs)
- licenses & permits
- consultancies
- inauguration
- working capital
- cash
- other



Initial capital requirement - 4

Format for estimating investment requirements

Expense items that repeat monthly

List of expense items

List of costs that do not repeat

List of costs

Monthly expense per item

Cash required (equal to monthly expense x 3)

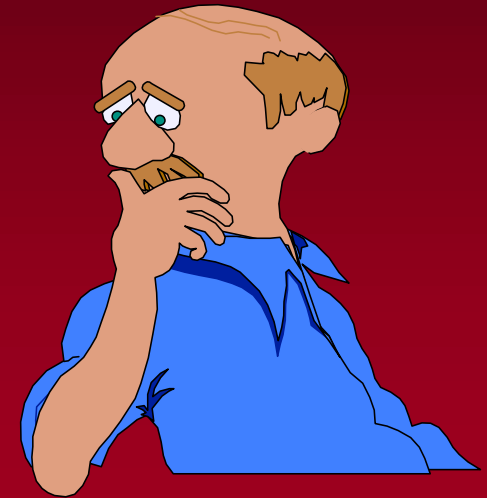
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Capital needed to start business/project

Financial projections - 1

- **Determine if you have enough capital.**
If not:
 - **Search for funds (get partners, request loans, sell stock)**
 - **Reduce business scale**
 - **Wait and save more funds**
 - **Stop the investment project**
- **Calculate first-year earnings.**
 - **Generate profitability**
 - **Finances expansion**
 - **Allows payment of interest & principal**



Financial projections - 2

- **Cost-Volumen-Profit analysis**
 - **Write down annual sales**
 - **Calculate variable or direct costs**
 - **Estimate fixed or indirect costs**
(administration plus marketing plus depreciation)
 - **Add investment expenses**

Sales	1000	100%
Less Variable costs	600	60%
Gross margin	400	40%
Less Fixed costs	500	50%
Profit or (Loss)	(100)	(10%)

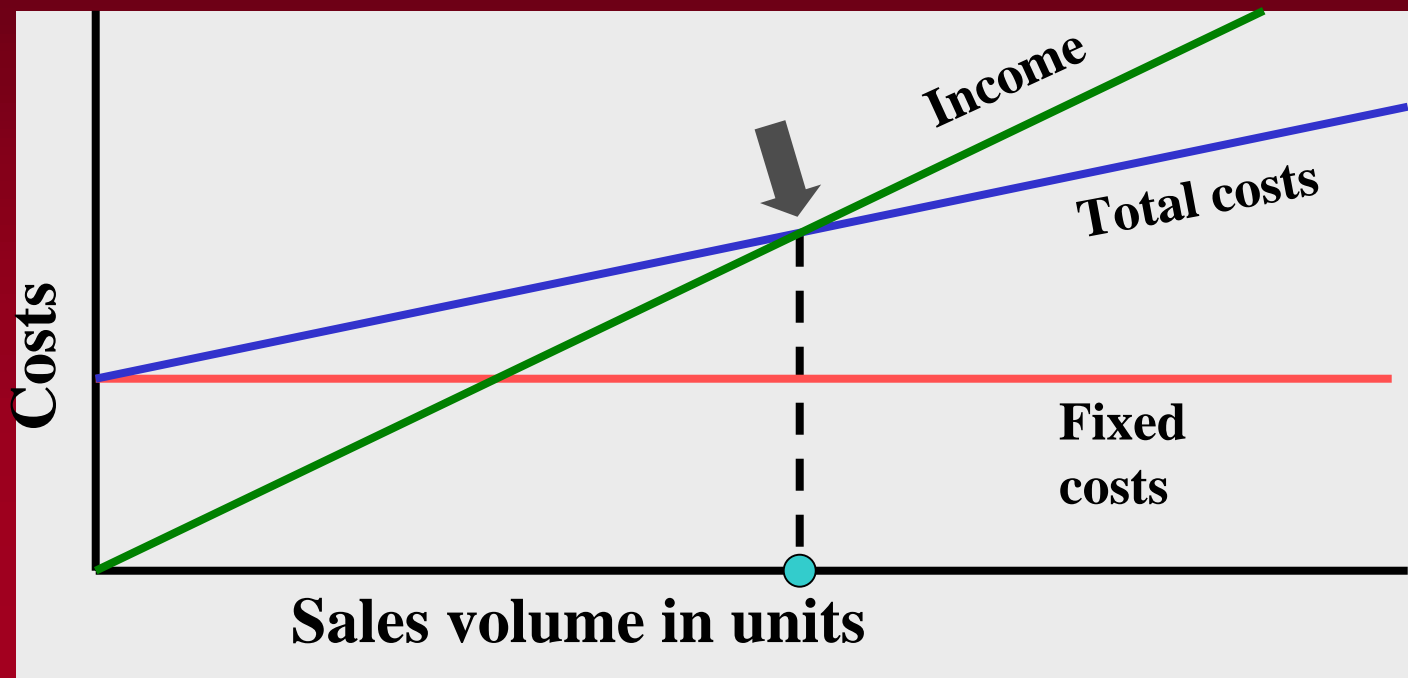
Financial projections - 3

- **Break-even analysis**
 - **Sales volume required so that total income is equal to total costs**
 - **Can be expressed in units (fixed costs/gross margin per unit)**
 - **Also in currency (fixed costs/gross margin as a percentage)**
 - **Used for:**
 - **calculating a level of sales that will generate a certain target profit**
 - **analyzing the effect of price on profits**
 - **effect of fixed costs in profits**

Break-even point analysis

Sales volume where income is equal to total costs (variable plus fixed costs)

$$\text{Break-even volume} = \frac{\text{Total fixed costs}}{\text{Unit price} - \text{Unit variable cost}}$$



Break-even point - Example

Vanilla cake

Basic information

Fixed costs = \$350.000/month

Net sales price per unit = \$8.000

Variable cost per unit = \$3.800

$$\text{Break-even volume} = \frac{\text{Fixed costs}}{\text{Unit price} - \text{Unit variable cost}}$$

$$\begin{aligned} \text{Break-even volume} &= \frac{350.000}{8.000 - 3.800} \\ &= 83 \text{ tortas} \end{aligned}$$

Break-even point - Example

Vanilla cake

Basic information

Fixed costs = \$350.000/month

Net sales price per unit = \$8.000

Variable cost per unit = \$3.800

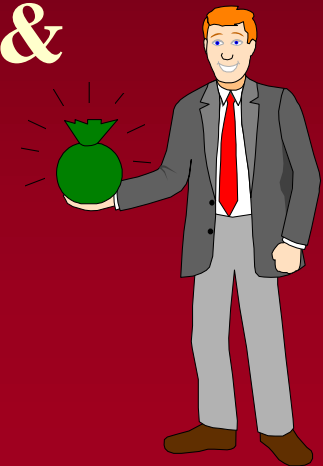
$$\text{Break-even sales} = \frac{\text{Fixed costs}}{\% \text{ Gross margin}}$$

$$\begin{aligned} \text{Break-even sales} &= \frac{350.000}{(8.000 - 3.800) / 8.000} \\ &= \$ 666.667 \end{aligned}$$

Financial projections - 4

- **The Cash Flow**

- **The enterprise can be profitable but be short of cash**
- **Cash flow statements help identify when disbursements are greater than receipts**
- **Prepare a list of monthly receipts & payments**
- **This way, the entrepreneur can plan ahead (loans)**
- **Strategies to accelerate payments**
- **Strategies to slow disbursements down**



Financial projections - 5

- **Financial statements**
 - **Initial balance sheet**
 - Shows the amount of assets, liabilities & net worth in a given date
 - $\text{Assets} = \text{Liabilities plus Net worth}$
 - **Projected Income statement for Year 1**
 - **Projected Balance sheet ending Year 1**
 - **Projected Financial statements for Years 2 and 3**



Financial projections - 6

Income statement

- Income minus expenses
- Summarizes results of enterprise operations during a time period

Sales

Cost of goods sold

Gross Margin

Less fixed expenses

Total expenses

Net profit from operations

Less interest expense

Net profit before taxes

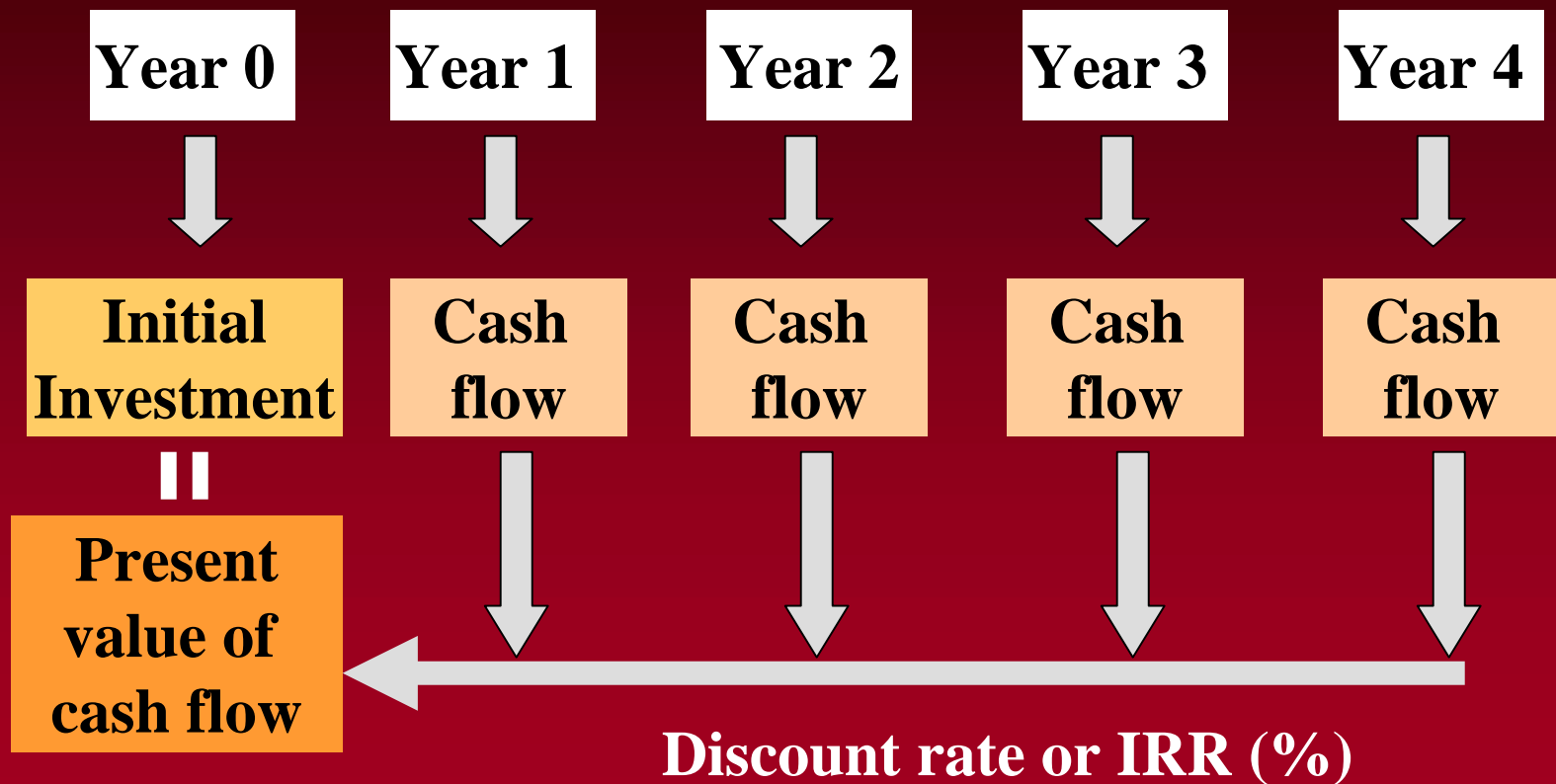
Taxes

Net income after taxes

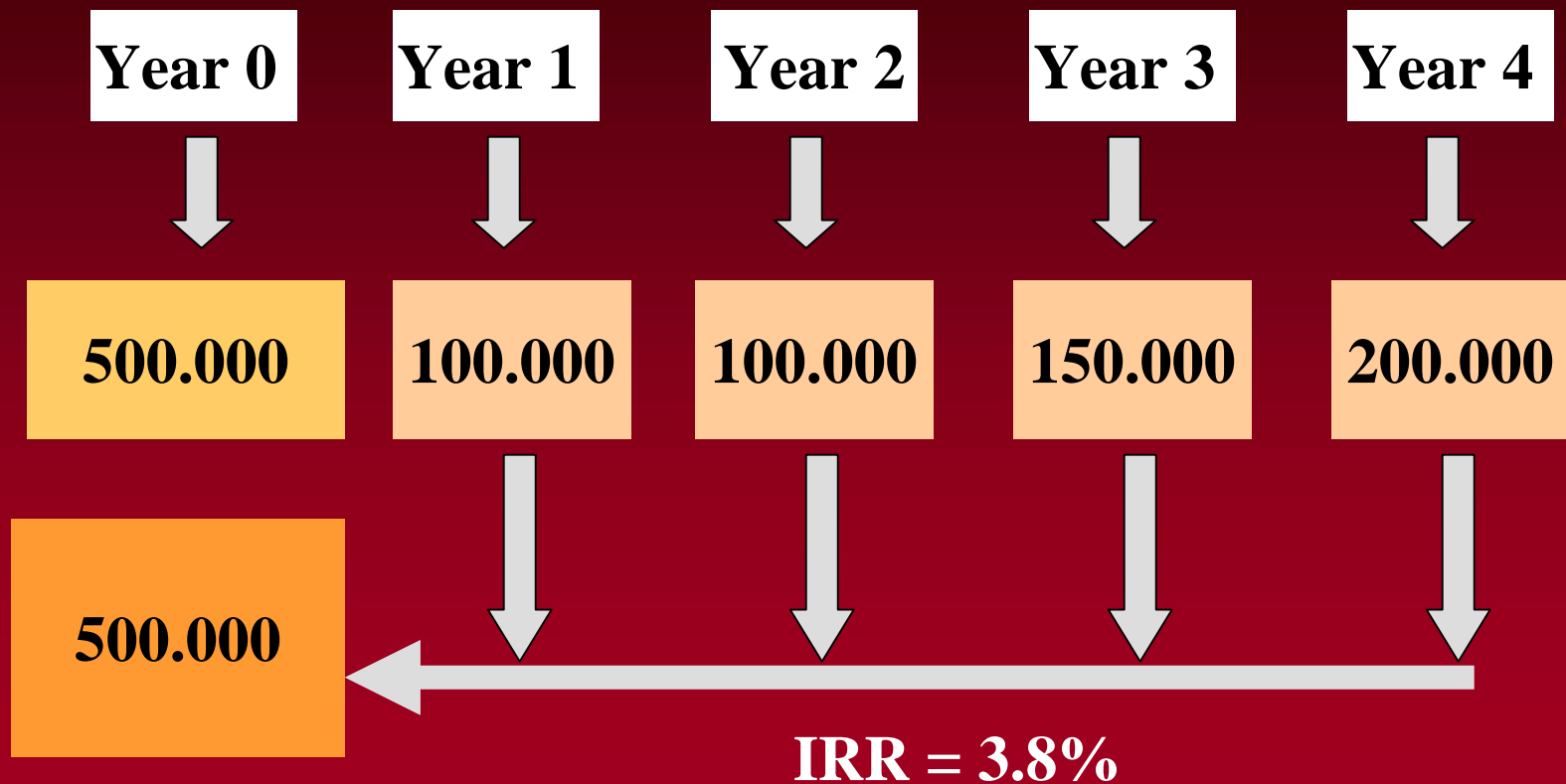
Calculating IRR

- **some annual cash flows can be negative**
- **the value of money decreases over time over time**
- **to compare the sum of annual cash flows with initial investment, we have to discount them to Year 0**
- **or else, we cannot compare apples with oranges**
- **the IRR is like the interest rate we obtain from a given investment**

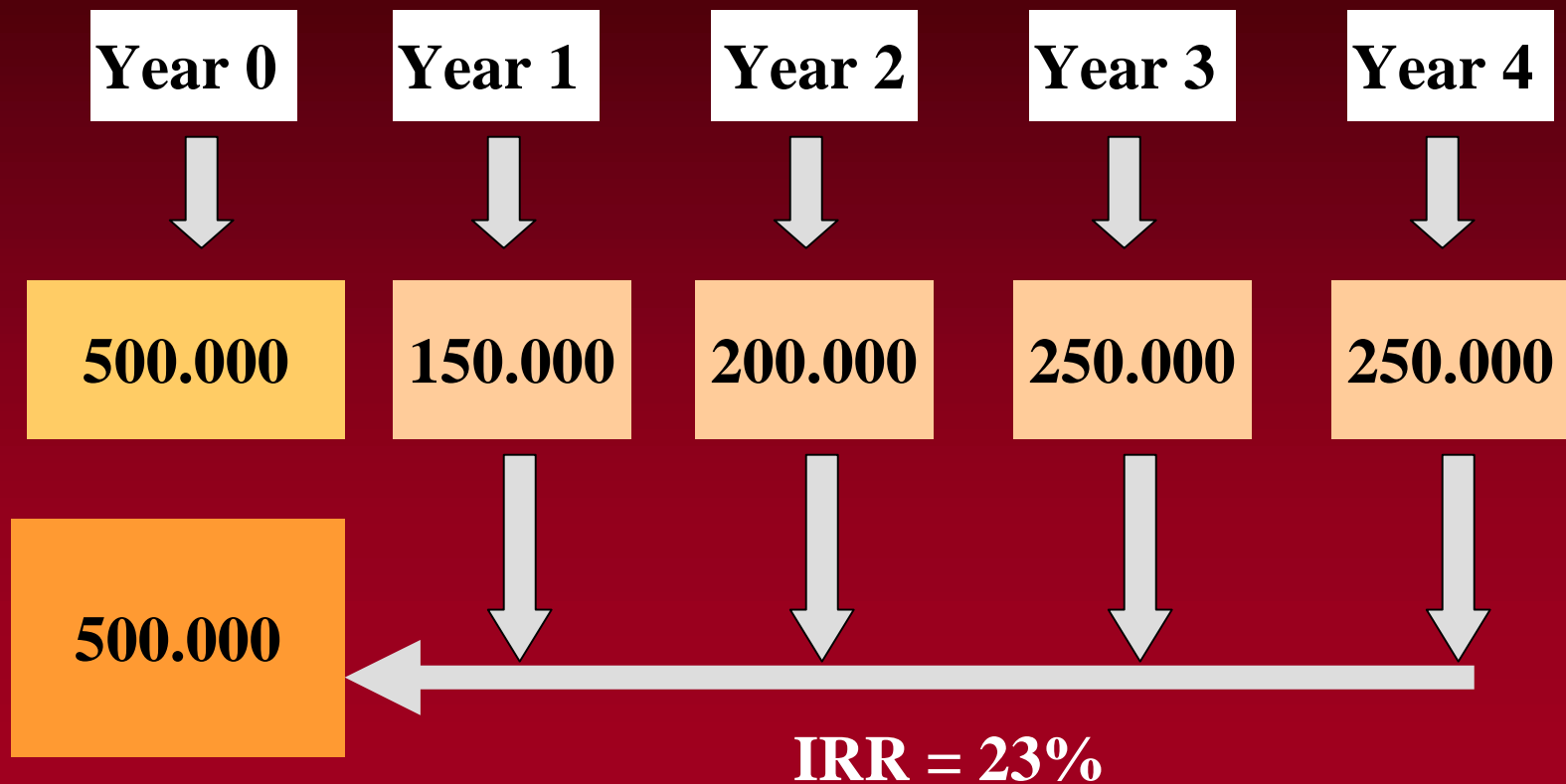
Graphic interpretation of the IRR



Example of IRR Calculation - 1



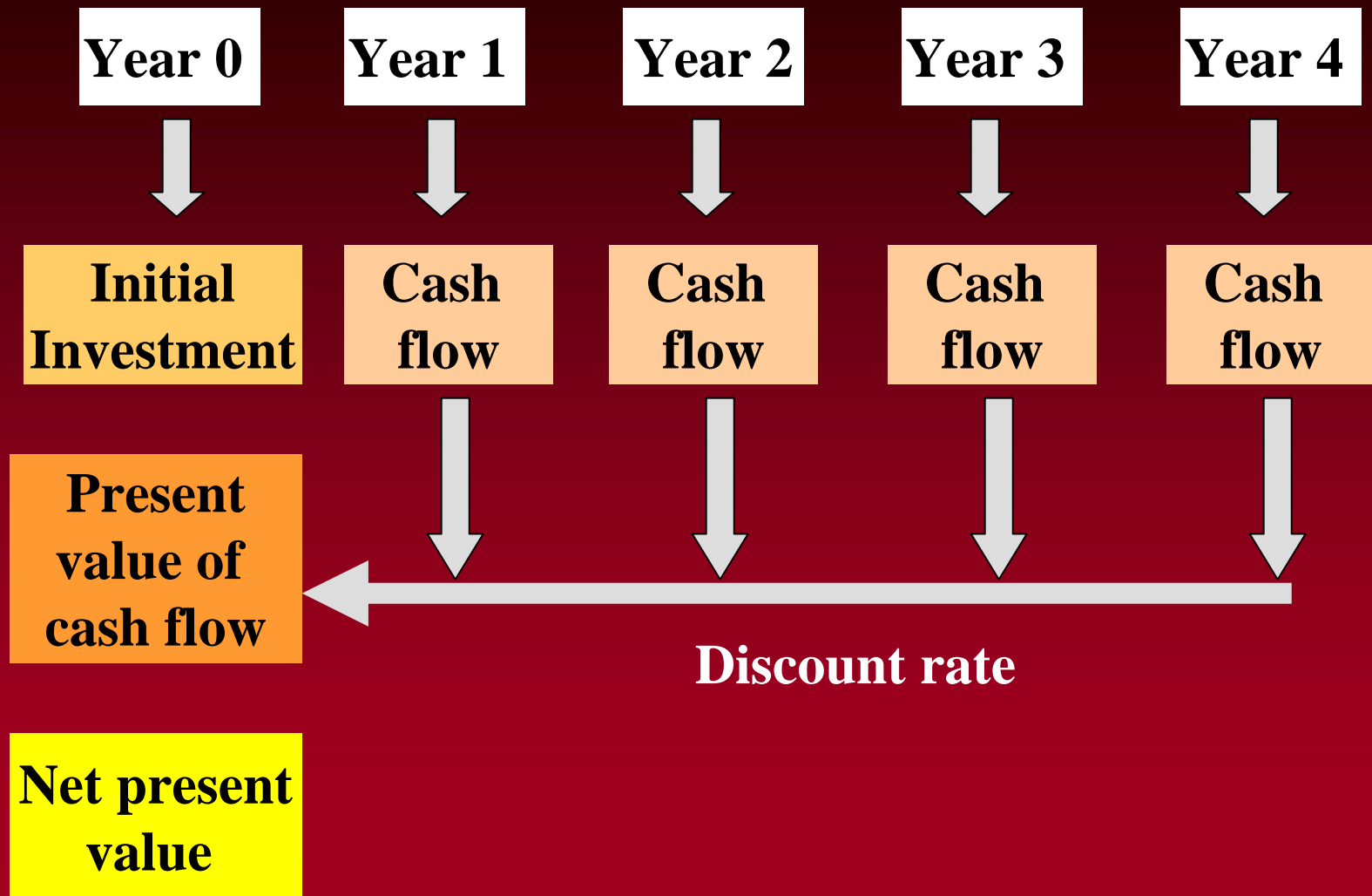
Example of IRR Calculation - 2



What is Net Present Value (NPV)?

- **The NPV is the value in Year 0 of a series of annual cash flows generated by a business if discounted using an interest rate equal to the opportunity cost of capital.**
- **Opportunity cost of capital is the average interest rate that can be obtained for savings.**
- **For example, the average amount of interest paid by financial institutions such as banks.**
- **The NPV should be greater than 0 plus a risk factor.**

Graphic interpretation of the NPV



Example of NPV calculation - 1

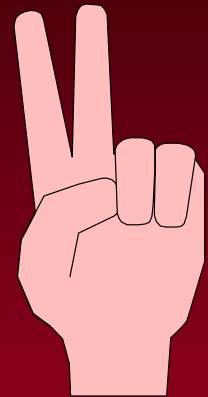


Example of NPV calculation - 2



What the investor looks for in a Business Plan (T.L. Dixon Technoserve Tanzania)

- **Quality of management: track record, ability to work together**
- **Persuasive business concept, innovative product**
- **Measure of product's value to customer**
- **Clearly reasoned strategy to win customers**
- **Assessment of competitors; realistic review of risks and opportunities**
- **Size of potential business**
- **Potential to protect the competitive advantage**
- **Exit strategies?**



Bankers and Venture Capitalists

(T.L. Dixon, Technoserve Tanzania)

- **Bankers are conservative; they look for risk minimization, collateral, coverage of payments**
- **Venture capitalists are innovators, they are looking for options to assume control; go public; cash out**
- **Venture capitalists look for high profits to offset high risks, especially for startups**
- **Out of ten VC investments:**
 - **1 will be a success**
 - **3 will offer modest returns**
 - **3 will gradually wither away**
 - **3 will be total losses**



The role of the Venture Capitalist

(T.L. Dixon, Technoserve)



- to inject money into start-ups
- to motivate and coach the start-up team
- to provide skills in forming new companies
- to serve as a source of contacts (key staff, strategic partners, other investors)
- to advise in making the business a success, with a view to cash out profitably
- “If I read 100 unsolicited plans a year, I’ll probably send out a form letter rejecting 80; I’ll talk to 20 prospects by phone, and I may invest in three to five proposals”.

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