**Business Plans that Can Influence Investors and Win Profits, Reprinted from "The Entrepreneurship Development Review"**

# Entrepreneurship and the Art of Raising Capital Funds:

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Entrepreneurs and investors have a common objective: both are interested in making a profit. A profit is earned if the capital project that the entrepreneur wants to launch has long-term viability. This common objective can be achieved if the entrepreneur is able to sell his project, and equally important, if the investor is able to understand what the project is all about. The instrument that helps to bridge this gap is the business plan. A business plan is the ticket of admission to the process of raising capital funds. Knowing what information to present in a business plan, how, to whom and why it should be presented enhances the chance for both to understand each other's interests. To negotiate a loan, to launch a project successfully and to establish a sound entrepreneur-investor courtship.

## Sell the Steak, not the Sizzle

Sales people learn early in their careers that if they are to succeed, they must learn to "sell the sizzle, not the steak". Joe Girard, dubbed the greatest salesman of all times, according to the Guinness Book of World Records, stated to a group of more than 700 sales persons recently that those who do not succeed in sales are selling the wrong thing: he claims that they should sell themselves, not the product.

However, in raising capital funds this basic rule does not apply; investors or lenders are not attracted by the sizzle - it is the steak that captures their attention. In the context of fund raising, a project is the steak, and investors want to know how much it will cost, how much funds are needed, its viability and many other things such as the sales and cost estimates, the profile of the owners, the technical and managerial competence of the management team, the competition, the financial plan, etc. The charm, warmth, and dashing, colourful or flashy personality of an entrepreneur plays second fiddle as far as investors are concerned; it is what can be harvested from the project that really counts.

This article illustrates how an entrepreneur can seize the interest of investors by preparing, presenting and selling a business plan. A business plan is a ticket of admission to the process of raising capital funds. Often, viable projects fail to proceed beyond loan negotiation. If entrepreneurs would take the time to make a careful and serious examination of their business plans, many would receive the seal of approval from their investors.

To attract the attention of investors, the entrepreneurs must understand:

1. What turns them "on" and "off".
2. What investors or lenders they should deal with.
3. What investors look for.
4. The type of information to present.
5. Why a business plan is important.

## What Turns Investors "On" and "Off"

People are turned "on" and "off" for different reasons; the same applies to investors. Entrepreneurs interested in raising funds can turn investors "on" and "off" easily. Investors receive hundreds of business plans regularly. As Richard Charpie, managing general

partner of Paine Webber Ventures points out, "We read 500 to 750 business plans a year - and we invest in six. And the 500 to 750 that we read are only a fraction of those that are submitted". Business plans are the instruments that should attract the interest of investors speedily, and not chill a potential relationship. Here are the most common reasons that turn investors "on" and "off".

### The major turn-on factors are:

1. Lenders like to see evidence that a product or service will sell. They want to see the product, feel it, see it in stores, look at customer reactions and even talk to them for feedback.
2. They like to be approached early enough. This gives them sufficient time to appraise the proposal and to review and discuss all components of the project with the entrepreneurs.
3. They like collateral which is a pledge offered by a business in exchange for a loan, or evidence of viability in exchange for equity. A business plan is no more than a "plan"; anything can happen. Collateral is like insurance; if something goes wrong, lenders like to be reassured that they can squeeze enough from the remains of a business if it ever folds. Viability, on the other hand, can be demonstrated by a strong management team, a good marketing program, and so on.
4. They appreciate an equitable capital structure, i.e. the relationship between the promoters' equity and the funds provided by investors or lenders. The more money the promoters invest in a business, the more confident the lenders or outside investors will be when injecting their own funds in a business.
5. They also like to see evidence of capacity, i.e. (a) the ability of the business to generate enough cash to meet its financial obligations (this can be ascertained by looking at the cash budget) and (b) the managerial competence and technical ability of the managers in areas such as production, finance, marketing, and distribution.

### The major turn-off factors are:

1. Promoters buy equipment or machinery before approaching lenders.
2. Sales projections are not realistic. Sometimes, entrepreneurs think that they are alone in the business and will submit unrealistic sales estimates. The project should reflect, as accurately as possible, the capital expenditures required, the viability of the project, and the ability of management to undertake the project.
3. Entrepreneurs are too product-oriented rather than focusing on the customer or the market.
4. Cost estimates deviate from industry norms. Lenders know the relationship between cost of sales to sales revenues, administration and selling cost to sales revenues, or profit margin or net profit to sales revenues for different types of industries, businesses or product lines. When an entrepreneur shows, for example, cost of sales to sales revenues at 50 per cent, while the industry norm is in the 65 per cent range, if such information is not substantiated the lenders or investors can readily discredit the entire business plan.
5. When the management team is nothing more than a one-man band; no one is identified.

## Shopping for Capital Funds

Funds can be obtained for different reasons, from different sources and in a variety of forms. Promoters must decide who to deal with: lenders, investors. Most important, they must find a strategy to reach the targeted financiers. Since lenders and investors come in all shapes and sizes with different interests, the idea is that the entrepreneur should approach the right financier.

Let's take the example of an entrepreneur who wants to start a new business and needs to purchase say, $1,000,000 worth of assets. This amount may include say $500,000 worth of current assets such as cash, accounts receivable and inventory. He may also need $500,000 worth of fixed assets such as land, building, machinery and equipment. The idea is to match the right financing with the right asset. To be sure, a home buyer would not purchase a house on his or her Master Card account, nor would he or she buy a car with mortgage money.

An entrepreneur can obtain funds from two principal sources: internal and external. Internal funds are generated by the business itself such as income from operations and a more efficient use of working capital accounts, such as reducing the inventories or accounts receivable or extending payments of accounts payables.

External financing can be obtained from shareholders (common or preferred shares) and from lenders (chartered banks, trade creditors, finance companies, trust companies, investment dealers or venture capitalists). The financial puzzle here is to match the right asset with the right financier. The following breaks down the different forms and sources of financing for various asset accounts under three main time periods (see Table 1 for detailed breakdown of different financing sources):

1. Short-term financing, i.e. borrowed capital to be repaid within a twelve month period.

**Table 1 Forms and Sources of Financing**

| Reasons for Financing | Forms | Sources |
|---|---|---|
| | **Short-term financing** | |
| Flexible current assets | | |
| Cash | Line of credit<br>Seasonal loan<br>Revolving credit<br>Notes payable<br>Single loan | Chartered banks |
| | Trade credit | Suppliers |
| Accounts receivable | Accounts receivable financing | Factoring companies |
| Inventory | Inventory financing (general lien, floor planning, warehouse financing) | Confirming institutions |
| | Consignment | Suppliers |
| Durable current assets | | |
| Accounts receivable and inventory | Working capital loans | Chartered banks<br>Government agencies |
| | **Intermediate financing** | |
| Machinery and equipment | Term loans<br>Conditional sales contracts<br>Sale and leaseback<br>Service leases<br>Financial leases | Chartered banks<br>Finance companies<br>Leasing companies |
| | **Long-term financing** | |
| Fixed assets | | |
| Land, buildings and heavy equipment | Leases (as above)<br>Bonds (secured and unsecured)<br>Mortgage | Leasing companies<br>Investment dealers<br>Pension, insurance and trust companies<br>Government agencies |
| | **Equity** | |
| | Retained earnings<br>Shares (common and preferred)<br>Grants | Reinvested income<br>Ownership investment<br>Government agencies |

2. Intermediate financing, i.e. borrowed capital which is to be repaid in one to five years.
3. Long-term financing, i.e. capital whose repayments can be made for a period of more than five years.

## What Lenders Look For

In general, lenders look for projects which are viable in the long run. However, some lenders are not willing to take risks (chartered banks, mortgage companies and finance companies) and require collateral as guarantees. Other financiers are willing to take greater risks, but, they will demand a greater return on their investment (e.g. venture capitalists). Despite their interests in investing in a capital project, before forming a financial partnership with a promoter, both usually ask penetrating questions such as: "What kind of entrepreneur am I dealing with? Will this project be able to pay its own way? What will happen if the venture goes bankrupt? Is the project part of an industry that is expanding, stable, or contracting? Are the promoters prepared to take a financial risk in the venture? If yes, to what extent? Irrespective of the type of financier or stakeholder, an entrepreneur who wants to negotiate funds should be able to answer these questions in his or her business plan.

The dozens or even hundreds of questions advanced by potential investors or lenders can be condensed into six words, commonly referred to as the C's of credit. They are: (1) character (reputation, honesty, dependability and integrity of the owners and managers); (2) collateral (assets pledged by a borrower as security on a loan); (3) capacity (ability of the business to meet its obligations and the managerial and technical abilities of the management team); (4) capital (the relationship between the promoters' equity and the external funds provided by other shareholders and lenders); (5) circumstances (the general and immediate environment such as trends in product demand, competition, government regulations); and (6) coverage (insurance coverage on the death of the principal owners, damage to the business resulting from fire, explosion, embezzlement, etc.)

Although traditional lenders such as chartered banks, finance companies or investment dealers analyze umpteen different items in capital projects prior

to approving a loan, there are however two factors that take priority when venture capitalists examine a business plan. They are: product/service and management. In their book, Business Plans that Win $ $ $, Stanley Rich and David Gumpert of the M.I.T. Enterprise Forum, and partners in Venture Resources, Inc. indicate that the quality of the product/service and the management team increases or decreases the desirability of the investment. To illustrate this point, they have developed a grid called "The Rich-Gumpert Evaluation System" shown in Figure 1.

**Figure 1 The Rich-Gumpert Evaluation System**

Most Desirable →

| Product/Service Status | | | | |
|---|---|---|---|---|
| **Level 4** Product/ service fully developed. Many satisfied users. Market established | 4/1 | 4/2 | 4/3 | 4/4 |
| **Level 3** Product/ service developed. Few (or no) users as yet. Market assumed | 3/1 | 3/2 | 3/3 | 3/4 |
| **Level 2** Product/ service pilot operable. Not yet developed for production. Market assumed | 2/1 | 2/2 | 2/3 | 2/4 |
| **Level 1** A product or service idea, but not yet operable. Market assumed | 1/1 | 1/2 | 1/3 | 1/4 |
| Management Status | **Level 1** A single would-be founder-entrepreneur | **Level 2** Two founders. Additional slots personnel not identified | **Level 3** Partly staffed management team. Absent members identified to join when firm is funded | **Level 4** Fully staffed, experienced management team |

Most Desirable ↑

Source: Stanley R. Rich and David E. Gumpert, *Business Plans that Win $ $ $*, Harper and Row, New York, 1985, p. 169.

The patrons of this grid describe the two-step process that venture capitalists use to evaluate plans. The first step is the qualitative assessment which is based on the product and the management team. This is how it works; a project that is located in the 4/4 zone on the grid means that the promoters of a project are presenting to the potential investors an accepted product or service, one that has been developed, produced and sold to customers who are happy with it. Also, all members of the management team are identified and fully committed.

A project that is in the 1/1 category gives a different story. In this case, a product or service can be summarized as follows: "Yes, it's a great idea, but . . ." The idea is impressive but it has not yet been developed even to the prototype stage. Also, management is only a one-person band - the founder. He or she is still looking around for others to join the management team.

The next step is the quantitative analysis. Here, the venture capitalist assesses the risk level in each case and determines the level of return he or she hopes to obtain from the deal. According to Rich and Gumpert, venture capitalists are looking for an annual return on their investment in the range of 35 per cent to more than 60 per cent, compounded, net of inflation. And, because there is a close link between risk and return, the venture capitalist will demand a yield between 35 per cent to 40 per cent on the 4/4 projects and at least 60 per cent on the 2/2 projects.

Whenever an entrepreneur has a project in mind, it may be worthwhile to study this evaluation system and pin-point where on the grid his or her project stands. This evaluation may also determine the chances for obtaining funds, what has to be done before meeting a lender or venture capitalist, and the cost of raising funds.

## Presenting a Business Plan that Sells

Since a business plan is the ticket of admission to the process of raising funds, and since hundreds of business plans are received by lenders, the document must have the right appearance, a sound structure, and contain the right type of information.

With regard to its appearance, a business plan should abide by the following rules:

1. be approximately 40 to 50 pages in length (appendices excluded);
2. be presented in a spiral binding between cover sheets;
3. be typed neatly (word processor if possible with block style);
4. have a cover and title page with name of promoters, addresses and telephone numbers and the date the document was prepared;
5. have well-designed title page;
6. include an executive summary indicating the key points of the proposal;
7. include a well-designed table of contents with each section listing a set of simple sequential page numbers (i.e. section 1 would be 1.1 to 1.10; section 2, 2.1 to 2.6 etc.)

With regard to the structure of the business, the nature of the project should dictate to a large degree the structure and relative importance of the type of information to be presented in a business plan. Project submissions should therefore be "tailor- made" to clarify important issues. For instance, a well- established firm may submit a project involving new products and markets. Since the firm is well established, its

management capability and financial position will not likely be at issue. Consequently, the business plan should cover these points briefly and concentrate its analysis on factors related to the industry environments, supported by details of project costs, the marketing program, R & D program, etc. On the other hand, a promoter, inexperienced and financially weak, might wish to invest in a sawmill complex - an industry promising favourable long-term performance. In this case, the business plan should emphasize management capability, the availability of raw material, manufacturing process, and financing, with less attention on the industry environment.

Also, it is quite evident that the structure of a business for a project-oriented manufacturing proposal is different than that of a retail store or restaurant business. Table 2 shows the typical table of contents of different types of business plans.

**Table 2 Table of Contents of Business Plans**

A. *The Generic Business Plan*
1. Past
   - Overall performance
   - Operating performance
   - Market performance
2. Present
   - Management and technical capability
3. Future
   - Statement of purpose
   - Environment
   - Ownership structure
   - Management team
   - Project team
   - Marketing plan
   - Manufacturing plan
   - R & D plan
   - Manpower plan
   - Locational plan
   - Financial plan

B. *High tech product*
1. The product
2. Suppliers
3. Components
4. Cost to Manufacture
5. Wholesale Cost
6. How the system works
7. Drawbacks
8. Existing Solar Products
9. The Market
10. Market Strategy
11. Marketing Plan
12. Product Testing
13. Manufacturing Facilities
14. Personnel
15. Research and Development
16. Production
17. Other Revenue Sources
18. Use of Proceeds
19. Management
20. Consultants
21. Corporate Officers
22. Other Key Personnel

Appendix
   A. Brochure
   B. Financial Plan
   C. Development Stage Financial Statement

C. *A Magazine*
1. Market Analysis
2. Editorial Objectives
3. The Consumer Magazine Industry
4. Personnel
5. Sales/Profit Forecast
6. Plan for Financing
7. Appendix

D. *Restaurant*
1. General description
2. Market
3. Location
4. Competition
5. Personnel
6. Management
7. Financial data
   - Balance Sheet
   - Breakdown Analysis
   - Income Projections
   - Working Capital Analysis
8. Supporting Documents

- The A plan is the generic type. Entrepreneurs can extract from this structure topics that pertain to their particular project.
- Business plan B is more specific and deals with the development and marketing of a high-tech product.
- Business plan C represents the structure of a project dealing with the launching of a new magazine.
- Business plan D shows the profile of a plan related to opening a restaurant.

## Why Prepare a Business Plan?

Entrepreneurs can benefit from a well-documented, formulated, and presentable business plan. From the entrepreneur's point of view, it: (1) shows specifically how the company intends to go about implementing the project (planning), and how it will be organized (who will do what and when); (2) forces management to do a realistic assessment of different operating units of their organization (strengths and weaknesses); (3) provides management with an instrument which can be used for monitoring the project implementation on a continual basis, and for taking corrective action if necessary and if project plans need adjustment; and (4) helps management to see that all resources of the business are used efficiently and effectively.

To the lenders, a sound business plan offers similar benefits; it: 1) provides a solid base on which to judge a company. With a business plan, lenders can assess readily the past performance of a business and see whether it has adequate resources to expand its operations successfully; (2) assures the stakeholders that management is aware of both the opportunities and potential difficulties related to the project; (3) indicates the company's ability to maintain and repay its debt load within the short-and medium-term and indicates the return provided by the project; (4) identifies all components of the company's operations, both internal, such as resources (financial, human, material, technological, material), and external (industry environment, competition, trends); (5) identifies the timing and nature of the future cash requirements; (6) enables stakeholders to assess management's ability to plan and organize the use of the resources efficiently and effectively; (7) indicates how much funding is needed, who will provide it, and when it will be required.

## Suggested Readings

Individuals who are in the business of helping, assisting, advising or providing consultative services to business operators or entrepreneurs should have in their home or business library the following books:


- Pierre G. Bergeron, Finance for Non-Financial Managers, Toronto: Methuen, 1985, 290 pp.
- Joseph R. Mancuso, How to Prepare and Present a Business Plan, Englewood Cliffs, New Jersey: Prentice-Hall, 1983, 316 pp.
- Stanley R. Rich and David E. Gumpert, Business Plans that Win $ $ $, New York: Harper and Row, 1985, 219 pp.