# How to Write a Winning Business Plan

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A comprehensive, carefully thought-out business plan is essential to the success of entrepreneurs and corporate managers. Whether you are starting up a new business, seeking additional capital for existing product lines, or proposing a new activity in a corporate division, you will never face a more challenging writing assignment than the preparation of a business plan.

Only a well-conceived and well-packaged plan can win the necessary investment and support for your idea. It must describe the company or proposed project accurately and attractively. Even though its subject is a moving target, the plan must detail the company's or the project's present status, current needs, and expected future. You must present and justify ongoing and changing resource requirements, marketing decisions, financial projections, production demands, and personnel needs in logical and convincing fashion.

Because they struggle so hard to assemble, organize, describe, and document so much, it is not surprising that managers sometimes overlook the fundamentals. We have found that the most important one is the accurate reflection of the viewpoints of three constituencies.

1. The market, including both existing and prospective clients, customers, and users of the planned product or service.
2. The investors, whether of financial or other resources.

*The business plan admits the entrepreneur to the investment process. Without a plan furnished in advance, many investor groups won't even grant an interview. And the plan must be outstanding if it is to win investment funds.*

*Too many entrepreneurs, though, continue to believe that if they build a better mousetrap, the world will beat a path to their door. A good mousetrap is important, but it's only part of meeting the challenge. Also important is satisfying the needs of marketers and investors. Marketers want to see evidence of customer interest and a viable market. Investors want to know when they can cash out and how good the financial projections are. Drawing on their own experiences and those of the Massachusetts Institute of Technology Enterprise Forum, the authors show entrepreneurs how to write convincing and winning business plans.*

*Mr. Rich has helped found seven technologically based businesses, the most recent being Advanced Energy Dynamics Inc. of Natick, Massachusetts. He is also a cofounder and has been chairman of the MIT Enterprise forum, which assists emerging growth companies.*

*Mr. Gumpert is an associate editor of HBR, where he specializes in small business and marketing. He has written several HBR articles, the most recent of which was "The Heart of Entrepreneurship," coauthored by Howard. H. Stevenson (March-April 1985).*

*This article is adapted from* Business Plans That Win $$$: Lessons from the MIT Enterprise Forum, *by Messrs. Rich and Gumpert (Harper & Row, 1985). The authors are also founders of Venture Resource Associates of Grantham, New Hampshire, which provides planning and strategic services to growing enterprises.*

3. The producer, whether the entrepreneur or the inventor.

Too many business plans are written solely from the viewpoint of the third constituency—the producer. They describe the underlying technology or creativity of the proposed product or service in glowing terms and at great length. They neglect the constituencies that give the venture its financial viability—the market and the investor.

Take the case of five executives seeking financing to establish their own engineering consulting firm. In their business plan, they listed a dozen types of specialized engineering services and estimated their annual sales and profit growth at 20%. But the executives did not determine which of the proposed dozen services their potential clients really needed and which would be most profitable. By neglecting to examine these issues closely, they ignored the possibility that the marketplace might want some services not among the dozen listed.

Moreover, they failed to indicate the price of new shares or the percentage available to investors. Dealing with the investor's perspective was important because—for a new venture, at least—backers seek a return of 40% to 60% on their capital, compounded annually. The expected sales and profit growth rates of 20% could not provide the necessary return unless the founders gave up a substantial share of the company.

In fact, the executives had only considered their own perspective—including the new company's services, organization, and projected results. Because they had not convincingly demonstrated why potential customers would buy the services or how investors would make an adequate return (or when and how they could cash out), their business plan lacked the credibility necessary for raising the investment funds needed.

We have had experience in both evaluating business plans and organizing and observing presentations and investor responses at sessions of the MIT Enterprise Forum. We believe that business plans must deal convincingly with marketing and investor considerations. This reading identifies and evaluates those considerations and explains how business plans can be written to satisfy them.

## EMPHASIZE THE MARKET

Investors want to put their money into market-driven rather than technology-driven or service-driven companies. The potential of the product's markets, sales, and profit is far more important than its attractiveness or technical features.

You can make a convincing case for the existence of a good market by demonstrating user benefit, identifying marketplace interest, and documenting market claims.

### Show the User's Benefit

It's easy even for experts to overlook this basic notion. At an MIT Enterprise Forum session an entrepreneur spent the bulk of his 20-minute presentation period extolling the virtues of his company's product—an instrument to control certain aspects of the production process in the textile industry. He concluded with some financial projections looking five years down the road.

The first panelist to react to the business plan—a partner in a venture capital firm—was completely negative about the company's prospects for obtaining investment funds because, he stated, its market was in a depressed industry.

Another panelist asked, "How long does it take your product to pay for itself in decreased production costs?" The presenter immediately responded, "Six months." The second panelist replied, "That's the most important thing you've said tonight."

The venture capitalist quickly reversed his original opinion. He said he would back a company in almost any industry if it could prove such an important user benefit—and emphasize it in its sales approach. After all, if it paid back the customer's cost in six months, the product would after that time essentially "print money."

The venture capitalist knew that instruments, machinery, and services that pay for themselves in less than one year are mandatory purchases for many potential customers. If this payback period is less than two years, it is a probable purchase; beyond three years, they do not back the product.

The MIT panel advised the entrepreneur to recast his business plan so that it emphasized the short payback period and played down the self-serving discussion about product innovation. The executive took the advice and rewrote the plan in easily understandable terms. His company is doing very well and has made the transition from a technology-driven to a market-driven company.

### Find out the Market's Interest

Calculating the user's benefit is only the first step. An entrepreneur must also give evidence that customers are intrigued with the user's benefit claims and that they like the product or service. The business plan must reflect clear positive responses of customer prospects to the question "Having heard our pitch, will you buy?" Without them, an investment usually won't be made.

## THE MIT ENTERPRISE FORUM

Organized under the auspices of the Massachusetts Institute of Technology Alumni Association in 1978, the MIT Enterprise Forum offers businesses at a critical stage of development an opportunity to obtain counsel from a panel of experts on steps to take to achieve their goals.

In monthly evening sessions the forum evaluates the business plans of companies accepted for presentation during 60- to 90-minute segments in which no holds are barred. The format allows each presenter 20 minutes to summarize a business plan orally. Each panelist reviews the written business plan in advance of the sessions. Then each of four panelists—who are venture capitalists, bankers, marketing specialists, successful entrepreneurs, MIT professors, or other experts—spends five to ten minutes assessing the strengths and weaknesses of the plan and the enterprise and suggesting improvements.

In some cases, the panelists suggest a completely new direction. In others, they advise more effective implementation of existing policies. Their comments range over the spectrum of business issues.

Sessions are open to the public and usually draw about 300 people, most of them financiers, business executives, accountants, lawyers, consultants, and others with special interest in emerging companies. Following the panelists' evaluations, audience members can ask questions and offer comments.

Presenters have the opportunity to respond to the evaluations and suggestions offered. They also receive written evaluations of the oral presentation from audience members. (The entrepreneur doesn't make the written plan available to the audience.) These monthly sessions are held primarily for companies that have advanced beyond the start-up stage. They tend to be from one to ten years old and in need of expansion capital.

The MIT Enterprise Forum's success at its home base in Cambridge, Massachusetts has led MIT alumni to establish forums in New York, Washington, Houston, Chicago, and Amsterdam, among other cities.

How can start-up businesses—some of which may have only a prototype product or an idea for a service—appropriately gauge market reaction? One executive of a smaller company had put together a prototype of a device that enables personal computers to handle telephone messages. He needed to demonstrate that customers would buy the product, but the company had exhausted its cash resources and was thus unable to build and sell the item in quantity.

The executives wondered how to get around the problem. The MIT panel offered two possible responses. First, the founders might allow a few customers to use the prototype and obtain written evaluations of the product and the extent of their interest when it became available.

Second, the founders might offer the product to a few potential customers at a substantial price discount if they paid part of the cost—say one-third—up front so that the company could build it. The company could not only find out whether potential buyers existed but also demonstrate the product to potential investors in real-life installations.

In the same way, an entrepreneur might offer a proposed new service at a discount to initial customers as a prototype if the customers agreed to serve as references in marketing the service to others.

For a new product, nothing succeeds as well as letters of support and appreciation from some significant potential customers, along with "reference installations." You can use such third-party statements—from would-be customers to whom you have demonstrated the product, initial users, sales repre-sentatives, or distributors—to show that you have indeed discovered a sound market that needs your product or service.

You can obtain letters from users even if the product is only in prototype form. You can install it experimentally with a potential user to whom you will sell it at or below cost in return for information on its benefits and an agreement to talk to sales prospects or investors. In an appendix to the business plan or in a separate volume, you can include letters attesting to the value of the product from experimental customers.

### Document Your Claims

Having established a market interest, you must use carefully analyzed data to support your assertions about the market and the growth rate of sales and profits. Too often, executives think "If we're smart, we'll be able to get about 10% of the market" and "Even if we only get 1% of such a huge market, we'll be in good shape."

Investors know that there's no guarantee a new company will get any business, regardless of market size. Even if the company makes such claims based on fact—as borne out, for example, by evidence of customer interest—they can quickly crumble if the company does not carefully gather and analyze supporting data.

One example of this danger surfaced in a business plan that came before the MIT Enterprise Forum. An entrepreneur wanted to sell a service to small businesses. He reasoned that he could have 170,000 customers if he penetrated even 1% of the market of 17 million small enterprises in the United States. The panel pointed out that anywhere from 11 million to 14 million of such so-called small businesses were really sole proprietorships or part-time businesses. The total number of full-time small businesses with employees was actually between 3 million and 6 million and represented a real potential market far beneath the company's original projections—and prospects.

Similarly, in a business plan relating to the sale of certain equipment to apple growers, you must have U.S. Department of Agriculture statistics to discover the number of growers who could use the equipment. If your equipment is useful only to growers with 50 acres or more, then you need to determine how many growers have farms of that size, that is, how many are minor producers with only an acre or two of apple trees.

A realistic business plan needs to specify the number of potential customers, the size of their businesses, and which size is most appropriate to the offered products or services. Sometimes bigger is not better. For example, a saving of $10,000 per year in chemical use may be significant to a modest company but unimportant to a Du Pont or a Monsanto.

Such marketing research should also show the nature of the industry. Few industries are more conservative than banking and public utilities. The number of potential customers is relatively small, and industry acceptance of new products or services is painfully slow, no matter how good the products and services have proven to be. Even so, most of the customers are well known and while they may act slowly, they have the buying power that makes the wait worthwhile.

At the other end of the industrial spectrum are extremely fast-growing and fast-changing operations such as franchised weight-loss clinics and computer software companies. Here the problem is reversed. While some companies have achieved multi-million-dollar sales in just a few years, they are vulnerable to declines of similar proportions from competitors. These companies must innovate constantly so that potential competitors will be discouraged from entering the marketplace.

You must convincingly project the rate of acceptance for the product or service—and the rate at which it is likely to be sold. From this marketing research data, you can begin assembling a credible sales plan and projecting your plant and staff needs.

## ADDRESS INVESTORS' NEEDS

The marketing issues are tied to the satisfaction of investors. Once executives make a convincing case for their market penetration, they can make the financial projections that help determine whether investors will be interested in evaluating the venture and how much they will commit and at what price.

Before considering investors' concerns in evaluating business plans, you will find it worth your while to gauge who your potential investors might be. Most of us know that for new and growing private companies, investors may be professional venture capitalists and wealthy individuals. For corporate ventures, they are the corporation itself. When a company offers shares to the public, individuals of all means become investors along with various institutions.

But one part of the investor constituency is often overlooked in the planning process—the founders of new and growing enterprises. By deciding to start and manage a business, they are committed to years of hard work and personal sacrifice. They must try to stand back and evaluate their own businesses in order to decide whether the opportunity for reward some years down the road truly justifies the risk early on.

When an entrepreneur looks at an idea objectively rather than through rose-colored glasses, the decision whether to invest may change. One entrepreneur who believed in the promise of his scientific-instruments company faced difficult marketing problems because the product was highly specialized and had, at best, few customers. Because of the entrepreneur's heavy debt, the venture's chance of eventual success and financial return was quite slim.

The panelists concluded that the entrepreneur would earn only as much financial return as he would have had holding a job during the next three to seven years. On the downside, he might wind up with much less in exchange for larger headaches. When he viewed the project in such dispassionate terms, the entrepreneur finally agreed and gave it up.

Investors' primary considerations are:

### Cashing out

Entrepreneurs frequently do not understand why investors have a short attention span. Many who see their ventures in terms of a lifetime commitment expect that anyone else who gets involved will feel the same. When investors evaluate a business plan, they consider not only whether to get in but also how and when to get out.

## PACKAGING IS IMPORTANT

A business plan gives financiers their first impressions of a company and its principals.

Potential investors expect the plan to look good, but not too good; to be the right length; to clearly and concisely explain early on all aspects of the company's business; and not to contain bad grammar and typographical or spelling errors.

Investors are looking for evidence that the principals treat their own property with care—and will likewise treat the investment carefully. In other words, form as well as content is important, and investors know that good form reflects good content and vice versa.

Among the format issues we think most important are the following:

### Appearance

The binding and printing must not be sloppy; neither should the presentation be too lavish. A stapled compilation of photocopied pages usually looks amateurish, while bookbinding with typeset pages may arouse concern about excessive and inappropriate spending. A plastic spiral binding holding together a pair of cover sheets of a single color provides both a neat appearance and sufficient strength to withstand the handling of a number of people without damage.

### Length

A business plan should be no more than 40 pages long. The first draft will likely exceed that, but editing should produce a final version that fits within the 40-page ideal. Adherence to this length forces entrepreneurs to sharpen their ideas and results in a document likely to hold investors' attention.

Background details can be included in an additional volume. Entrepreneurs can make this material available to investors during the investigative period after the initial expression of interest.

### The cover and title page

The cover should bear the name of the company, its address and phone number, and the month and year in which the plan is issued. Surprisingly, a large number of business plans are submitted to potential investors without return addresses or phone numbers. An interested investor wants to be able to contact a company easily and to request further information or express an interest, either in the company or in some aspect of the plan.

Inside the front cover should be a well-designed title page on which the cover information is repeated and, in an upper or a lower corner, the legend "Copy number ________" provided. Besides helping entrepreneurs keep track of plans in circulation, holding down the number of copies outstanding - usually to no more than 20—has a psychological advantage. After all, no investor likes to think that the prospective investment is shopworn.

### The executive summary

The two pages immediately following the title page should concisely explain the company's current status, its products or services, the benefits to customers, the financial forecasts, the venture's objectives in three to seven years, the amount of financing needed, and how investors will benefit.

This is a tall order for a two-page summary, but it will either sell investors on reading the rest of the plan or convince them to forget the whole thing.

### The table of contents

After the executive summary include a well-designed table of contents. List each of the business plan's sections and mark the pages for each section.

Because small, fast-growing companies have little cash available for dividends, the main way investors can profit is from the sale of their holdings, either when the company goes public or is sold to another business. (Large corporations that invest in new enterprises may not sell their holdings if they're committed to integrating the venture into their organizations and realizing long-term gains from income.)

Venture capital firms usually wish to liquidate their investments in small companies in three to seven years so as to pay gains while they generate funds for investment in new ventures. The professional investor wants to cash out with a large capital appreciation.

Investors want to know that entrepreneurs have thought about how to comply with this desire. Do they expect to go public, sell the company, or buy the investors out in three to seven years? Will the proceeds provide investors with a return on invested capital commensurate with the investment risk—in the range of 35% to 60%, compounded and adjusted for inflation?

Business plans often do not show when and how investors may liquidate their holdings. For example, one entrepreneur's software company sought $1.5 million to expand. But a panelist calculated that, to satisfy their goals, the investors "would need to own the entire company and then some."

## Making Sound Projections

Five-year forecasts of profitability help lay the groundwork for negotiating the amount investors will receive in return for their money. Investors see such financial forecasts as yardsticks against which to judge future performance.

Too often, entrepreneurs go to extremes with their numbers. In some cases, they don't do enough work on their financials and rely on figures that are so skimpy or overoptimistic that anyone who has read more than a dozen business plans quickly sees through them.

In one MIT Enterprise Forum presentation, a management team proposing to manufacture and market scientific instruments forecast a net income after taxes of 25% of sales during the fourth and fifth years following investment. While a few industries such as computer software average such high profits, the scientific instruments business is so competitive, panelists noted, that expecting such margins is unrealistic.

In fact, the managers had grossly—and carelessly—understated some important costs. The panelists advised them to take their financial estimates back to the drawing board and before approaching investors to consult financial professionals.

Some entrepreneurs think that the financials are the business plan. They may cover the plan with a smog of numbers. Such "spreadsheet merchants," with their pages of computer printouts covering every business variation possible and analyzing product sensitivity, completely turn off many investors.

Investors are wary even when financial projections are solidly based on realistic marketing data because fledgling companies nearly always fail to achieve their rosy profit forecasts. Officials of five major venture capital firms we surveyed said they are satisfied when new ventures reach 50% of their financial goals. They agreed that the negotiations that determine the percentage of the company purchased by the investment dollars are affected by this "projection discount factor."

## The Development Stage

All investors wish to reduce their risk. In evaluating the risk of a new and growing venture, they assess the status of the product and the management team. The farther along an enterprise is in each area, the lower the risk.

At one extreme is a single entrepreneur with an unproven idea. Unless the founder has a magnificent track record, such a venture has little chance of obtaining investment funds.

At the more desirable extreme is a venture that has an accepted product in a proven market and a competent and fully staffed management team. This business is most likely to win investment funds at the lowest costs.

Entrepreneurs who become aware of their status with investors and think it inadequate can improve it. Take the case of a young MIT engineering graduate who appeared at an MIT Enterprise Forum session with written schematics for the improvement of semiconductor-equipment production. He had documented interest by several producers and was looking for money to complete development and begin production.

The panelists advised him to concentrate first on making a prototype and assembling a management team with marketing and financial know-how to complement his product-development expertise. They explained that because he had never before started a company, he needed to show a great deal of visible progress in building his venture to allay investors' concern about his inexperience.

## The Price

Once investors understand a company qualitatively, they can begin to do some quantitative analysis. One customary way is to calculate the company's value on the basis of the results expected in the fifth year following investment. Because risk and reward are closely related, investors believe companies with fully developed products and proven management teams should yield between 35% and 40% on their investment, while those with incomplete products and management teams are expected to bring in 60% annual compounded returns.

Investors calculate the potential worth of a company after five years to determine what percentage they must own to realize their return. Take the hypothetical case of a well-developed company expected to yield 35% annually. Investors would want to earn 4.5 times their original investment, before inflation, over a five-year period.

After allowing for the projection discount factor, investors may postulate that a company will have $20 million annual revenues after five years and a net profit of $1.5 million. Based on a conventional multiple for acquisitions of ten times earnings, the company would be worth $15 million in five years.

If the company wants $1 million of financing, it should grow to $4.5 million after five years to satisfy investors. To realize that return from a company worth $15 million, the investors would need to own a bit less than one-third. If inflation is expected to average 7.5% a year during the five-year period, however, investors would look for a value of $6.46 million as a reasonable return over five years, or 43% of the company.

For a less mature venture—from which investors would be seeking 60% annually, net of inflation—a $1 million investment would have to bring in close to $15 million in five years, with inflation figured at 7.5% annually. But few businesses can make a convincing case for such a rich return if they do not already have a product in the hands of some representative customers.

The final percentage of the company acquired by the investors is, of course, subject to some negotiation, depending on projected earnings and expected inflation.

## MAKE IT HAPPEN

The only way to tend to your needs is to satisfy those of the market and the investors—unless you are wealthy enough to furnish your own capital to finance the venture and test out the pet product or service.

Of course, you must confront other issues before you can convince investors that the enterprise will succeed. For example, what proprietary aspects are there to the product or service? How will you provide quality control? Have you focused the venture toward a particular market segment, or are you trying to do too much? If this is answered in the context of the market and investors, the result will be more effective than if you deal with them in terms of your own wishes.

An example helps illustrate the potential conflicts. An entrepreneur at an MIT Enterprise Forum session projected R&D spending of about half of gross sales revenues for his specialty chemical venture. A panelist who had analyzed comparable organic chemical suppliers asked why the company's R&D spending was so much higher than the industry average of 5% of gross revenues.

The entrepreneur explained that he wanted to continually develop new products in his field. While admitting his purpose was admirable, the panel unanimously advised him to bring his spending into line with the industry's. The presenter ignored the advice; he failed to obtain the needed financing and eventually went out of business.

Once you accept the idea that you should satisfy the market and the investors, you face the challenge of organizing your data into a convincing document so that you can sell your venture to investors and customers. We have provided some presentation guidelines in the insert called "Packaging is Important."

Even though we might wish it were not so, writing effective business plans is as much an art as it is a science. The idea of a master document whose blanks executives can merely fill in—much in the way lawyers use sample wills or real estate agreements—is appealing but unrealistic.

Businesses differ in key marketing, production, and financial issues. Their plans must reflect such differences and must emphasize appropriate areas and deemphasize minor issues. Remember that investors view a plan as a distillation of the objectives and character of the business and its executives. A cookie-cutter, fill-in-the-blanks plan or, worse yet, a computer-generated package, will turn them off.

Write your business plans by looking outward to your key constituencies rather than by looking inward at what suits you best. You will save valuable time and energy this way and improve your chances of winning investors and customers.