AGRICULTURAL ALTERNATIVES

agalternatives.aers.psu.edu

Developing a Business Plan

An important task in starting a new venture is to develop a business plan. As the phrase suggests, a business plan is a "road map" to guide the future of the business or venture. A business plan will enter into the daily decisions of the business and provide direction for expansion, diversification, and evaluation of the business.

This publication will help you create your own business plan. It includes a discussion of the makeup of the plan and the information needed to develop a business plan. Business plans are traditionally developed and written by the owner with input from family members. Business plans are "living" documents that should be reviewed and updated at least every year. Reviews reinforce the thoughts and plans of the owner and the business and aids in the evaluation process. Evaluation determines if the business is in need of change or if it is meeting the expectations of the owners.

Using the Proper Format

The presentation of the plan should be as professional as possible to portray your business in a positive manner. When dealing with a lender or possible investor, the plan will be reviewed for accuracy and suggestions for changes to the plan may be offered. The decision to recommend the loan to the appropriate committee or reject the proposal will be largely based on your business plan. Often loan officers will not know a great deal about the proposed venture, but they will know the correct structure of a business plan. Investors will make their decision based on the plan and the integrity of the owner. For this reason, a professional format is necessary. After loan officers complete their evaluations, the loan committee will further review the business plan and make a decision. The committee members will spend limited time reviewing the document, focusing on the message of the executive summary and financial statements to make their determination. Because of this, these portions need to be the strongest parts of the plan and based on sound in-depth research and analysis.

This publication was developed by the Small-scale and Part-time Farming Project at Penn State with support from the U.S. Department of Agriculture–Extension Service.

PENNSTATE

1855

College of Agricultural Sciences
Agricultural Research and Cooperative Extension

The Sections of the Business Plan

A business plan should be structured like a book with the title page first, followed by a table of contents. Following these two pages, the main parts of the plan should appear in this order: executive summary, business mission statement, goals, and objectives, background information, organizational matters, marketing plan, and financial plan.

Executive Summary

The executive summary is placed at the front of the business plan, but it should be the last part to be written. The summary describes the business or proposed changes to the existing business, and the industry of which the business is or will be a part. Research findings and recommendations should be summarized concisely to provide the reader with the information required to make any decisions. The summary outlines the direction and future plans or goals of the company and the methods that will be used to achieve these goals.

The summary includes background information used to make these recommendations. The final financial analysis and the assumptions used are also a part of the executive summary. The analysis should show how proposed changes will ensure the sustainability of the current or proposed business. All challenges facing the existing business or proposed venture should also be discussed in this section. Identifying such challenges shows the reader that all considerations have been explored and taken into account during the research process.

Mission, Goals, and Objectives

This section has three separate portions. It begins with a brief, general description of the existing or planned business. The overview is followed by the mission statement of the business. The mission statement should be a maximum of three sentences and include the key ideas about why the business exists. An example of a mission statement for a produce farm may be: *The mission of XYZ Produce is to provide fresh, healthy produce to our customers, and to provide a safe, friendly working environment for our employees.*

The third and final portion sets the business's goals and objectives. There are at least two schools of thought about goals and objectives. One school of thought is that the goals are the means of achieving the objectives, and the other is exactly the opposite—that the objectives are the means of achieving the goals. Whichever school you follow, this is a very important part of the business plan. These goals and objectives should show the reader what the business wishes to accomplish and the steps needed to obtain the desired results. Goals or objectives should follow the acronym SMART, which stands for: **S**pecific, **M**easurable, **A**ttainable, **R**easonable, and **T**imed. Goals or objectives should follow this format to allow for evaluation of the entire process and provide valuable feedback along the way. The business owner should continually evaluate the outcomes of decisions and practices to determine if the goals or objectives are being met and make modifications when needed.

Background Information

Background information should come from the research conducted during the writing process. This portion should include information regarding the history of the industry, the current state of the industry, and information from reputable sources concerning the future of the industry. This portion of the business plan requires the most investment of time by the writer, with information gathered from multiple sources to prevent bias or undue optimism. The writer should take all aspects of the industry and business into account. If there are concerns or questions about the viability of the industry or business, these must be addressed. In writing this portion of the plan, information may be obtained from your local public library, periodicals, industry personnel, and publications such as the *Agricultural Alternatives* series. Industry periodicals are another excellent source of up-to-date information. The more varied the sources, the better the evaluation of the industry and the business, and the greater the opportunity to have a viable plan.

Once the decision is made as to the type of business, the detailed planning can begin. The business owner first decides the structure of the business. The business structure will have an impact on the future of the business. If the incorrect structure is chosen, the business may be negatively impacted down the road.

Organizational Matters

This section of the plan describes the business structure, the management team, and risk management strategies. This section describes how the business is or will be structured. There are several forms of business structure to choose from including sole-proprietorship, partnership, corporations (both subchapter S and subchapter C), cooperative, and limited liability corporations and partnerships (LLCs and LLPs). These business structures are discussed in *Agricultural Alternatives: Starting or Diversifying an Agricultural Business.*

The type of business structure is an important decision and often requires legal advice. The business structure should fit the management skills and styles of the owner or owners. For example, if there is more than one owner or multiple investors, a sole-proprietorship is not an option since more than one person has invested time and/or money into the business. In this case a partnership, cooperative, corporation, LLC, or LLP would be the proper choice.

If the business is not a sole-proprietorship, the management team should be described. The management team should consist of all parties involved in the decisions and activities of the business. The strengths and backgrounds of the management team should be discussed to highlight the positive aspects of the team.

Regardless of the business structure, all businesses should also have an external management support team. This external management support team should consist of the business's lawyer, accountant, insurance agent or broker, and possibly a mentor. These external members are an integral part of the management team. Many large businesses have these experts on staff. For small businesses, the external management team replaces full-time experts; the business owner(s) should consult with this external team on a regular basis (at least once a year) to determine if the business is complying with all rules and regulations. Listing the management team in the business plan allows the reader to know that the business owner has developed a network of experts to provide advice.

The risk management portion of the business plan provides a description of how the business will handle unexpected or unusual events. For example, if the business engages in agricultural production, will the business purchase crop insurance? Does the business have adequate liability insurance? Is the business diversified to protect against putting all its eggs in one basket? If the business has employees, does the business carry adequate workers' compensation insurance? All of these questions should be answered in the risk management portion of the business plan. More information on the use of insurance as a risk management tool can be found in *Agricultural Alternatives: Agricultural Business Insurance.* The business structure will also determine a portion of the risk management strategy. How the business is structured carries varying levels of risk to the owner and/or owners. The marketing strategies or objectives carry with them a degree of risk and should be evaluated and included in this portion of the plan.

Marketing Plan

Every product you buy is bought because the company selling the product has a carefully developed marketing strategy or plan. Consumers buy products based on brand name, price, quality, and many personal reasons. These consumer preferences are developed over time and an effective marketing plan takes these preferences into account. Your business should develop its marketing plan to be included in the business plan.

In order to be viable, the marketing plan must coincide with the production activities. The marketing plan must respond to consumer desires and needs. For example, if a perishable or seasonal crop (such as strawberries) is being proposed, the marketing plan should not include sales of locally grown berries in January. If the business plans to purchase berries in the off-season from other sources to market, this information needs to be included. The marketing plan must fit the production capabilities or the capability to obtain products from other sources.

A complete marketing plan should identify target customers, including where they live, work, and purchase the product or service you are providing. Products may be sold directly to the consumer (retail) or through another business (wholesale). If the business is in the wholesale market, decide if the market can bear more of what you are producing. The industry research will assist in this determination. The plan must also address the challenges of the marketing strategy proposed. This portion of the plan contains a description of the characteristics and advantages of your product or service. Identifying a "niche" market will be of great value to your business.

Other variables to consider are sales location, market location, promotion and advertising, pricing, staff, and the costs associated with all of these. All of these aspects of the marketing plan will take time to develop and should not be taken lightly. Further discussion on marketing fruits and vegetables can be found in *Agricultural Alternatives: Fruit and Vegetable Marketing for Small-Scale and Part-Time Growers.*

An adequate way of determining the answers to marketing issues is to conduct a SWOT analysis. The acronym SWOT stands for **S**trengths, **W**eaknesses, **O**pportunities, and **T**hreats. Strengths are considered mostly internal and may include aspects like experience in the business. Previous sales or marketing experience would be an area of strength for a retail farm market. Weaknesses are also mostly internal and may include aspects such as introduction of a new product or service. Opportunities are both internal and external by definition. If no one is offering identical products or services in your immediate area, you may have the opportunity to capture the market. Threats are both internal and external and may include aspects like other businesses offering the same product in close proximity to your business.

Financial Plan

One of the foremost reasons new businesses fail is not having enough start-up capital or inadequate financial planning. The scope of the business will be determined by the financial resources it can acquire. The business will also need to develop a financial plan and the supporting documents for that plan. The financial plan and assumptions are crucial to the success of the business and should be included in the business plan.

The financial plan is developed from historical data if you are an existing business and from projections for proposed businesses. The first issue to address is recordkeeping. You should indicate who will keep the records and how these records will be used. Internal controls, such as who will sign checks and handle any funds, should also be addressed in this section. A good rule to follow for businesses other than sole-proprietorships is having at least two people sign all checks.

The next portion of the financial plan should be financial assumptions. This includes if and when the business will need additional capital, how much capital will be needed, and where these funds will be obtained. If start-up capital is needed, this information should be included in this portion. Personal contributions should be included, along with other funding sources. The amount of money and repayment terms should be listed. One common mistake affecting many new businesses is under-funding at start-up. Owners too often do not carefully evaluate all areas of expenses and realize the amount of capital needed to see a new business through the development stages.

Typically, a balance sheet, income statement, cash flow statement, and partial budget are included in a business plan. These documents will display the financial information in a form that lending institutions are used to seeing. If these are not prepared by an accountant, having one review them will be beneficial to ensure proper format.

Financial projections should be completed for at least two years and, ideally, for five years. In agricultural businesses, five-year projections are sometimes difficult to make because of the variability in prices, weather, and other aspects affecting production. One way to illustrate these risks is to develop several scenarios covering a range of production assumptions. A set of projections should be included for each scenario. This attention to detail will often result in a positive experience with lenders because they realize that the plan covers several possible circumstances and provides insight into how the business will deal with challenges over the next several years. More information on financing agricultural businesses can be found in the publication *Agricultural Alternatives: Financing Small-Scale and Part-Time Farms.*

Financial Statements

Balance Sheet

A balance sheet is a snapshot of a business's assets, liabilities, and owner's equity at a specific point in time. A balance sheet can be prepared at any time, but is usually done at the end of the fiscal year. Evaluating the business by using the balance sheet requires several years of balance sheets to tell the true story of the progress of the business. A balance sheet is typically constructed by listing the assets on the left and the liabilities and owner's equity on the right. The difference between the assets and liabilities of the business is called the "owner's equity" and provides an estimate of how much of the business is owned outright. Owner's equity provides the "balance" in a balance sheet.

Balance sheets may be calculated on a market-basis or a cost-basis for the assets. A market-basis balance sheet better reflects the current economic conditions because of the current or market value for the assets. Market values are more difficult to obtain because of the difficulty in finding accurate current prices of assets. Cost-basis balance sheets are more conservative because the values are often from prior years. For example, a cost-basis balance sheet would use the value of land purchased ten years prior to completing the balance sheet at its original purchase price. Because purchase records are easily obtained, constructing a cost-basis balance sheet is easier. Depreciable assets such as buildings, tractors, and equipment are listed on the cost-basis balance sheet at purchase price less accumulated depreciation. Most accountants use the cost-basis balance sheet method. Whichever form is used, consistency over the years is critical.

Assets are anything owned by or owed to the business. These include cash (and checking account balance), accounts receivable (money owed to the business), inventory (any crops or supplies that the business has stored on farm), land, equipment, and buildings. This may also include machinery, breeding stock, and fruit trees. Sometimes assets are listed as current (those easily converted to cash) and fixed (those that are required for the business to continue). Assets are anything of value.

Liabilities are what the business owes on the date the balance sheet is prepared. Liabilities include both current liabilities (accounts payable, any account the business has with a supplier, short-term notes, operating loans, and the current portion of long-term debt), which is payable within the current year and noncurrent liabilities (mortgages and loans over one year).

Owner's equity is money that the owner(s) have invested in the business, profits that are retained in the business, and changes caused by fluctuating market values (on a market-basis balance sheet). Owner's equity will only occur when changes in capital contributed to the business or retained earnings are realized. On the balance sheet, owner's equity plus liabilities equals assets. Or, stated another way, all of the assets less the amount owed (liabilities) equals the owner's equity (sometimes referred to as "net worth").

Income Statement

The income statement is a summary of the income (revenue) and expenses for a given accounting cycle. If the balance sheet is a snapshot of the financial health of the business, the income statement is a motion picture of the financial health of the business over a specific time period. An income statement is constructed by listing the income (or revenue) at the top of the page and the expenses and the profit or loss at the bottom of the page.

Revenue is any income realized by the sale of crops or livestock, government payments, and any other income the business may have (including such items as fuel tax refunds, patronage dividends, and custom work). Other items impacting revenues are changes in inventory and accounts receivable (even if these changes are negative).

Expenses include any expense the business has incurred from the production of the products sold. Examples of expenses include feed, fertilizer, pesticides, fuel, labor, maintenance and repairs, insurance, taxes, and any changes in accounts payable. Depreciation, which is the calculated wear and tear on assets (excluding land), is included as an expense for accounting purposes. Interest is considered an expense, but any principal payments are not an expense.

As the income statement is created, the desired outcome is to have more income than expenses, so the income statement shows a profit. If not, the final number is shown in parentheses (signifying a negative number). Another name for this financial record is a Profit and Loss Statement. Income statements are one way to clearly show how the farm is making progress from one year to the next and may show a much more optimistic view of sustainability than can be seen by looking at the balance sheet.

Cash Flow Statement

A cash flow statement is the predicted flow of cash into and out of a business over a year. The cash flow statement is used to predict when additional cash is needed and when the business will have a surplus to pay back any debt. Cash flow statements are prepared by showing the total amounts predicted for each item of income or expense. This total is then broken down by month to show when surpluses and shortfalls in cash will occur. This monthly prediction allows the owner(s) to better evaluate the cash needs of the business, when to arrange financing, and when loans may be repaid. The cash flow statement often uses the same categories as the income statement plus additional categories to cover debt payments and borrowing.

After these financial analyses are completed, the business plan writer will have an accurate picture of how the business has performed and can project how the business will perform in the coming year(s). With such information, the reader of the business plan will be able to evaluate the viability of the business and will have an accurate understanding of the business. This understanding will enable them to make better informed decisions regarding loans or investments in the business.

Putting It All Together

After you have covered your mission, background information, organization, and marketing and financial plans, you will write the executive summary. Armed with all of the research and thought that went into the other sections, your business will come alive with the words that you put in this section. The next step is to share this plan with others whose opinions you respect. Have them ask you the hard questions such as having you defend an opinion you have expressed or challenging you to describe what you plan to do in more detail. Often, people are hesitant to share what they have written with their families or friends because they fear the plan will not be taken seriously. However, it is much better to receive constructive criticism from family and friends (and gain the opportunity to strengthen your plan) than it is to take it immediately to the lender, only to have any problems pointed out and receive a rejection.

Summary

Once the business plan is completed, you will have a document that will enable you to analyze your business and determine which, if any, changes need to be made. Changes on paper take time and effort but are not as expensive as changing a business practice only to find that the chosen method is not viable. For a proposed venture, if the business plan shows that the proposal is not viable, large sums of money have not been invested and possibly lost. Challenges are better faced on paper than with investment capital.

Remember, a business plan is a "road map" that will guide the future of the business. The business plan is a document in continual change because of influences on the business from the outside world. The plan will give you confidence to consider changes in the business to remain competitive. Once the plan is in place, the business will have a better chance of future success.

For More Information

Abrams, R., and E. Kleiner (2003). *The Successful Business Plan: Secrets and Strategies.* Palo Alto, Calif.: Planning Shop.

Dethomas, A., L. Grensing-Pophal, A. R. Dethomas, and L. Grensing (2001). *Writing a Convincing Business Plan.* Hauppauge, N.Y.: Barron's Educational Series.

Horan, J. T. Jr., et al (1998). *The One Page Business Plan: Start with a Vision, Build a Company.* Berkeley, Calif.: One Page Business Plan Company.

Lesonsky, R. (2001). *Start Your Own Business: The Only Start-Up Book You'll Ever Need.* Irvine, Calif.: Entrepreneur Media Inc.

O'Donnell, M. (1991). *Writing Business Plans That Get Results.* New York, N.Y.: McGraw-Hill Trade.

Patsula, P. J. (2002). *Successful Business Planning in 30 Days: A Step-by-Step Guide for Writing a Business Plan and Starting Your Own Business.* Mansfield, Ohio: Patsula Media.

Peterson, S. D. (2001). *Business Plan Kit for Dummies (With CD-ROM).* For Dummies: Book and CD-ROM Edition. Indianapolis, Ind.: Wiley Publishing.

Periodicals

American Agriculturist Magazine
Farm Progress Companies Inc.
191 S. Gary Ave.
Carol Stream, IL 60188
www.AmericanAgriculturist.com

BusinessWeek Magazine
www.businessweek.com

Fortune Magazine
www.fortune.com

Kiplinger's Personal Finance Magazine
www.kiplinger.com/magazine

Money Magazine
www.money.cnn.com

Web Sites

BizPlanit—Virtual Business Plan
www.bizplanit.com/vplan.htm.

NxLevel—Agricultural Business Planning
nxlevel.org/Pages/ag.html.

Small Business Administration
www.sba.gov/starting_business/planning/basic.html

SCORE—volunteer business assistance
www.score.org.

The Pennsylvania State University, Farm Management Extension
farmmanagement.aers.psu.edu

Prepared by Lynn F. Kime, extension associate in the Department of Agricultural Economics and Rural Sociology; Winifred W. McGee, county extension director in Lebanon County; Steven M. Bogash, extension educator in Franklin County; and Jayson K. Harper, professor of agricultural economics.

Additional financial support for this publication was provided by the Risk Management Agency of the United States Department of Agriculture and the Pennsylvania Department of Agriculture.

RMA

Pennsylvania Department of AGRICULTURE

Visit Penn State's College of Agricultural Sciences on the Web: **www.cas.psu.edu**

Penn State College of Agricultural Sciences research, extension, and resident education programs are funded in part by Pennsylvania counties, the Commonwealth of Pennsylvania, and the U.S. Department of Agriculture.

This publication is available from the Publications Distribution Center, The Pennsylvania State University, 112 Agricultural Administration Building, University Park, PA 16802. For information telephone 814-865-6713.

Produced by Information and Communication Technologies in the College of Agricultural Sciences

CAT UA405 5M10/04ps3995g