

A PROCESS MODEL OF BUSINESS PLAN DEVELOPMENT

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ABSTRACT

Current writing on the subject of business plan development almost uniformly follows an approach of asking an entrepreneur to use a template for a business plan or to answer numerous detailed questions regarding the various aspects of the proposed business. This method produces frustration on the part of many entrepreneurs because the templates or lists of questions do not follow the thinking processes that they engage in as they initially conceptualized the business and as they then begin to think through issues of operations, competition, finance, and others. As an alternative to the Template Model, this paper suggest a Process Model of business plan development that lays out 10 steps for the entrepreneur to follow either on his or her own or with a business advisor. These steps generally follow the more typical and more organic way that entrepreneurs develop business ideas and plans. The Process Model deals with key concepts first and then works toward developing the detail of a complete plan.

INTRODUCTION

Creating business plans is one of the most important functions that entrepreneurs engage in because business plans are often prerequisites for obtaining financial and other resources that entrepreneurs require for creating and growing their ventures. There is also a growing body of research that points to business plans as an effective tool for developing and monitoring internal business operations. Pedagogy for business plan creation is, therefore, one of the most important functions of entrepreneurship education programs. Most curricula in entrepreneurship include courses or programs in the development of business plans and there are numerous books on the subject.

Most approaches to business plan creation use what I will call the Template Model. In this approach the author of the business plan follows an outline, or

template, and basically goes through the outline filling in the blanks. Sometimes these templates are converted into lists of questions such as "How much debt do you expect to raise?" or "How much would you like to earn from your business?" While there are certain plusses to this template approach, such as quickly introducing the entrepreneur to many issues that will need attention, it often leads to frustration on the part of the entrepreneur and, ultimately, to plans that read like copies of previous plans for other businesses often from distant industries. It often seems to me that answering questions like these early in the process of plan development are like being asked to produce a shopping list for cooking a meal before you have decided what to cook.

The alternative to the Template Model is an approach that follows the more logical process of thinking, analysis, and strategic planning that goes into business plan development that I will call a Process Model. In my experience working with hundreds of entrepreneurs, teaching courses on business plan development, interviewing funding sources such as bankers, venture capitalists, and angel investors, and writing on the topic, the Process Model represents a more organic approach that leads to less frustration, higher rates of plan completion, and, most importantly, better, more compelling plans.

The purpose of this article is to review the literature on business plans including their use and value, detail and give some examples of the Template Model, and propose a detailed Process Model for business plan creation.

The Planning Function for Entrepreneurs

The value of planning is demonstrated best by looking at a profession in which virtually all the work is planning, for example architects. Architects develop plans that are usually executed by others professions for structures that are paid for and lived in by the client. Yet, new structures or modifications to existing structures of more than minimal scale are rarely carried out without the plans produced by architects. There are several reasons for this. First, projects requiring government approvals or permits often mandate architect-certified plans. Second, building projects require many decisions and specifications and it is easier, faster, and cheaper to make these decisions on paper or on a computer screen than by rearranging actual buildings, steel girders, or bricks once the building project has begun. Finally, and perhaps most importantly, planning allows for testing the viability and safety of structures in a cost effective manner. Prior to the development of scientifically based architecture tools, innovative structures such as

cathedrals met or failed their test of soundness only after being built – and many failed that test.

Entrepreneurial ventures can benefit similarly from planning. First, investors, lenders, and the Small Business Administration serve a similar role to both the consumers and government agencies, requiring plans before giving their approvals to investments and loans. Second, budgeting on paper or a spreadsheet allows for the myriad of decisions (and their complex interactions) that an entrepreneur must make such as hiring, marketing, capital investment, and many more to be observed and tested in a virtual and no-risk environment before being tried in reality. Finally, there is growing evidence that planning actually leads to lower rates of business failure, just as it did for buildings.

Research on Planning

There is surprisingly little research that goes directly to the issue of whether formal business plans increase positive business outcomes generally and virtually none directly related to entrepreneurs. Research currently being carried out at the Lawrence N. Field Center for Entrepreneurship and Small Business at Baruch college that tracks start-up rates for aspiring entrepreneurs, preliminarily points to much higher actual start-ups among those who complete business plans, but part of this preliminary result could be related to the fact that people who abandon business ideas or decide to pursue other career paths have no need to complete a plan. Longer term data which is in the process of being collected will show if people who completed plans have higher success rates or greater business growth in business than those who started businesses without plans. Again, the preliminary data point to positive effects of plan creation.

Perry (2001) examined matched samples of firms that entered formal bankruptcy and those that did not and compared them with regard to how much formal business planning was engaged in by each category. Overall, Perry concluded that all firms engaged in little formal planning, but that the firms that failed engaged in less than the firms that did not fail. A recent study by Gibson and Cassar (2002) found that engaging in formal planning correlates with variables such as firm size, owner's education level, training, and intention to change. But this study does not address the long or short-term effects of planning on firm performance. Berman et al. (1997) found a positive relationship between financial planning and growth while O'Neill et al. (1987) failed to show any relationship between formal planning and performance.

One of the limitations of the research is that much of it defines planning in the broadest sense and does not focus on the creation of business plans by entrepreneurs. Nonetheless, as a normative matter, management and entrepreneurship writers continue to strongly recommend that entrepreneurs engage in significant, formalized planning. Examples of this include Timmons (1999), Longenecker, et al. (1994), Stevenson et al. (1999), and Scarborough and Zimmerer (2003).

METHODOLOGY

This study grows out of several qualitative research approaches to this subject. First, the literature on business plan development was reviewed. This literature is summarized in the previous section to this paper. Second, virtually every textbook and trade book on the subject of business plan creation was reviewed. Without exception, all the existing books on the subject rely on a template model as described below. Third, I taught graduate and undergraduate level classes on business plan creation for eight years, bringing me into contact with more than 350 students going through the process of creating a business plan for their course project. Fourth, I worked as a Faculty Mentor in an entrepreneurship center. In this capacity, I worked with several hundred business owners and aspiring entrepreneurs who were creating business plans.

This qualitative research approach lead me to a clear conclusion that template models were producing frustrations among students and business owners who were writing business plans, regardless of the books or other materials that they used.

During this experience, I began to extensively interview those who were writing plans to see the origins of their frustration and to discern their thought processes. This lead to a conclusion that a more deductive, process model would better match the thinking that went into the formulation of business ideas and then to their specific plans. In all, 63 of these open-ended interviews took place over a two-year period.

Finally, I began to create materials that more closely matched this deductive process that aspiring entrepreneurs were following. Throughout this interviewing period, the process model as presented below was refined and finalized through use with more than 150 people who were developing business plans. My subjective observations are that the level of frustration decreased and the speed at which the plans were completed increased.

THE TEMPLATE MODEL

The Template Model of business plan development gives the entrepreneur an outline of a plan or a list of questions to answer. Often it gives both an outline and list of questions. The textbooks listed above all give outlines, and, with the exception of the Stevenson text which has less of emphasis on business plan creation, they all give questions. The Timmons text also gives a detailed personal inventory questionnaire before taking its readers into business plan creation. Typically, these books give their readers approximately 100 headings under the business plan outline and an equal or greater number of questions on various lists broken out by functional areas of management such as finance, organization, or marketing.

In my experience there is nothing wrong with the content of the outline or the questions, but the structure of the process of creating a plan from a template does not follow how entrepreneurs think about creating their business. Generally, I see people who have a concept that evolves through various stages of growing complexity and detail into a full plan. The result of attempting to answer the questions or follow the template that takes into great detail too soon is that the entrepreneur becomes discouraged soon after starting to work on the template or are forced to answer questions out of sequence, meaning before they have addressed the underlying strategies. For example, without having arrived at a strategy and understanding of one's competitive advantage it is difficult to address most marketing questions.

Table 1 is a simple outline given on the Small Business Administration website that demonstrates this and is generally typical of what is seen in most entrepreneurship books that cover the subject of business plan development.

Table 1 Outline for a Business Plan Provided the U.S. Small Business Administration	
Introduction	
o	Give a detailed description of the business and its goals.
o	Discuss the ownership of the business and the legal structure.
o	List the skills and experience you bring to the business.
o	Discuss the advantages you and your business have over your competitors.

Table 1 Outline for a Business Plan Provided the U.S. Small Business Administration	
Marketing	
o	Discuss the products/services offered.
o	Identify the customer demand for your product/service.
o	Identify your market, its size and locations.
o	Explain how your product/service will be advertised and marketed.
o	Explain the pricing strategy.
Financial Management	
o	Explain your source and the amount of initial equity capital.
o	Develop a monthly operating budget for the first year.
o	Develop an expected return on investment and monthly cash flow for the first year.
o	Provide projected income statements and balance sheets for a twoyear period.
o	Discuss your breakeven point.
o	Explain your personal balance sheet and method of compensation.
o	Discuss who will maintain your accounting records and how they will be kept.
o	Provide "what if" statements that address alternative approaches to any problem that may develop.
Operations	
o	Explain how the business will be managed on a day-to-day basis.
o	Discuss hiring and personnel procedures.
o	Discuss insurance, lease or rent agreements, and issues pertinent to your business.
o	Account for the equipment necessary to produce your products or services.

Table 1	
Outline for a Business Plan Provided the U.S. Small Business Administration	
o	Account for production and delivery of products and services.
Concluding Statement	
o	Summarize your business goals and objectives and express your commitment to the success of your business.

Table 2 presents a list of questions the same SBA website suggest answering as part of developing a marketing plan.

Table 2	
Questions for the Entrepreneur Provided the U.S. Small Business Administration	
Develop a marketing plan for your business by answering these questions. (Potential franchise owners will have to use the marketing strategy the franchisor has developed.) Your marketing plan should be included in your business plan and contain answers to the questions outlined below.	
o	1. Who are your customers? Define your target market(s).
o	2. Are your markets growing? steady? declining?
o	3. Is your market share growing? steady? declining?
o	4. If a franchise, how is your market segmented?
o	5. Are your markets large enough to expand?
o	6. How will you attract, hold, increase your market share? If a franchise, will the franchisor provide assistance in this area? Based on the franchisor's strategy? how will you promote your sales?
o	7. What pricing strategy have you devised?

I have seen many business owners and aspiring entrepreneurs attempt to address these questions and become quickly frustrated because they have not yet addressed the fundamental, conceptual issues that must underlie every business. Virtually every business plan textbook or pamphlet takes this same approach.

THE ALTERNATIVE: A PROCESS MODEL OF BUSINESS PLAN CREATION

In working with hundreds of business owners and aspiring entrepreneurs as they go through the process of creating business plans, I have seen the frustrations that they encounter as they face a template of an outline or a long list of detailed questions. The Process Model that I present below, strives to proceed from the general to the specific while at the same time moving from issues of how the business will be of service to others to what the business will need from others to be successful. I believe that this approach can be used in one-on-one counseling or in a classroom setting and will lead to higher quality plans more quickly than the Template Model.

Step 1: Define The Company: What will it accomplish for others?

Defining the company consists of specifying the needs that the company will satisfy for its customers. Entrepreneurs tend to define their ventures in terms of what it will accomplish for them, but ultimately this is irrelevant to getting customers, lenders, investors, or partners. Potential investors need to know that the business will be meaningful and marketable to people who can use your product or service. Therefore, this step concentrates on the external needs that will be met. Examples of these include a product or service that enable people to do something better, more cheaply, more safely, or more efficiently.

Step 2: Identify The Venture's Initial Needs: What will the venture require to get started?

Whether an entrepreneur wants to buy an existing company with 300 employees or you can start a business by only adding an extra phone line to a home office desk, they need to make a list of the needed materials. Some may be tangible, such as five hundred file folders and a large cabinet in which to store them all. Other requirements may be intangible, such as time to create a product design or to do market research on potential customers. One venture may require hiring an assistant to develop a retrievable filing system for the five hundred folders, or hire a consultant to set up a computer system that's beyond your technical skills.

If the entrepreneur is going to build a better mousetrap, he or she may have constructed a prototype out of used toothpaste tubes and bent paperclips at home,

but will need a sturdier, more attractive model to show potential investors. What exactly will your mousetrap look like? What materials will be needed? Does it require money for research and development to improve on the original toothpaste tube and paper clip construction? Does it need to hire an engineer to draw up accurate manufacturing designs? If the entrepreneur wants to open a restaurant, he or she will have to figure out how much money will be needed to cover rent, equipment and renovations before turning a profit. This step involves doing a great deal of homework such as calling real estate brokers and looking at actual potential spaces.

Step 3: Choosing A Strategy: How will one distinguish the product or service from others?

Although there are millions of types of businesses, there are actually only a few basic strategies that can be applied to make any enterprise successful. It is important to see the strategic options and understand the reasoning behind the selection of one over others. The first step in selecting an effective strategy is for the entrepreneur to identify a competitive advantage for his or her product or service. How will they establish that their product or service is better, cheaper, more delicious, or more convenient? Competitive advantage may include designing special features not found in rival products. It may entail superior service characteristics such as speedier delivery, a lower price, or more attentive sales people.

Suppose an entrepreneur wants to open a restaurant that serves squid flavored pancakes. What will its competitive advantage be? Do people in the neighborhood devour other squid based dishes and can't seem to get their fill? Have all the other pancake restaurants in the community failed to include squid flavored items on their menus? Is squid much cheaper to acquire than other more traditional pancake ingredients, such as bananas? Will that enable the business to charge much less for all the items on your menu, including banana pancakes? Will the decor of the restaurant be so enticing to squid lovers that they'll come in to look around and then discover how delicious your squid pancakes can be?

In short, the entrepreneur must have a reason why the business will succeed. This is the competitive advantage and once there is a competitive advantage established, a strategy can be selected.

Step 4: Analyze the Potential Markets: Who will want the product or service?

In this step, the entrepreneur defines the target market for the business' product or service, covering such issues as age, gender, profession, ethnicity, race, economic characteristics, location, and size. Once the target market is defined then the entrepreneur can research the numbers: How many car mechanics, house painters or bathroom contractors are there in any given community? How many children in the United States are currently under the age of eight? How much soap will they use in a month or a year? How many other soap manufacturers already have a share of the market? How big are the potential competitors? Identifying the target market is one of the great satisfactions of starting one's own business. At this stage, entrepreneurs are thinking about the actual people who will use their product or service.

Step 5: Develop a Marketing Campaign: How will the business reach customers and what will be the message?

Entrepreneurs, especially inventors, often believe that their business concept is so spectacular that promoting their product or service won't be necessary. Sort of a "build it and they will come" attitude, especially if what you're building is the proverbial better mousetrap. One of the most common flaws I see in plans is the entrepreneur's failure to describe exactly how customers will be reached and how products will be presented to them. Potential investors, staff, and partners won't be convinced that an idea can succeed until there are established well-researched and effective methods of contacting customers – and the assurance that once they are reached, they can be convinced to buy the product or service.

Suppose hypothetically an entrepreneur wants to open a financial services business to advise Wall Street investors who wish to buy stocks in the rubber sole industry. The entrepreneur already identified the target market as major New York City based investors interested in rubber sole stocks and the competitive advantage as the entrepreneur's unparalleled expertise in rubber sole stocks.

Some of the questions that have to be answered to develop a marketing campaign include: What trade journals and newspapers do potential clients read? Would ads in these publications be worth the cost of placing them? How could one interest a reporter for one of these periodicals in writing a story about this new advisory firm? Is there an organization of rubber sole company investors that the

entrepreneur should join? Are there conventions for investors in rubber sole companies that would be worth attending?

Step #6: Build A Sales Effort: How will the business attract customers?

The word "sales" covers all the issues related to making contact with actual customers once the entrepreneur has established how to reach them through the marketing campaign. How will the sales staff be trained to approach potential customers? Will the sales staff be divided up so some become experts in selling one or a few types of customers? What advertising and promotional efforts will be employed?

In planning sales activities, the entrepreneur also needs to answer questions such as: Is it ethical to contact colleagues and clients from his or her former job? Will the entrepreneur be the only salesperson in the beginning stages of the company? When will he or she know it's time to hire additional sales staff? What will the basic sales philosophy be – building long-term relationships with a few major clients or developing a clientele of many short-term customers?

The entrepreneur will also need to consider how you will compensate the sales staff – with a base salary plus a commission or just a commission? Knowledge of the competitive advantage is just as important in designing a dynamic sales effort as it is in developing an effective marketing campaign. The entrepreneur needs to think about what product or service qualities will be the most compelling to prospective customers. Then he or she has to devise convincing language that clearly communicates this competitive advantage to the sales staff who will in turn use it when talking to customers. In my experience, the most important element of an effective sales effort is having a sales staff that thoroughly understands the business and the needs of potential customers. Therefore, the sales plan must address the issue of how to create a sales staff that is as knowledgeable about your business as it is about your potential customers.

Step # 7: Design the Company: How will the business hire and organize its workforce?

By the time the entrepreneur has reached the stage of thinking about the potential business concept, he or she probably has a good idea of the number of people they will need and the skills they will require to get the enterprise up and running.

The entrepreneur needs to focus on establishing that he or she capable of running the business. Perhaps they are not, and need to bring in experienced managers. They need to know where they will find these potential employees.

The entrepreneur will need to specify the key management jobs and roles. Positions such as president, vice presidents, chief financial officer, and managers of departments will need to be defined along with stating who reports to whom. Many people may hope to run their companies as one big happy family – and it may work out that way – but organizations require formal structure and investors will expect to see these issues addressed ultimately in a plan.

Issues such as how to find the right consultants, whether the entrepreneur will collect a salary, when will it be time to hire a staff, what skills must they have, how will they be recruited them, and how will the company be structured so the chain of command and quality control are maintained if the company grows dramatically, all need to be thought through.

Step # 8: Target the Funding Sources: Where will the financing come from?

As the business concept begins to take shape, the entrepreneur can begin to hone in on the most likely financing sources. Issues such as the size of the business, the industry it is in, whether it is a start-up the purchase of an existing business, and whether the entrepreneur can provide collateral to a lender are among the issues that must be considered in creating a target list of funding sources. Banks and other funding sources don't lend money because people with interesting business ideas are nice. The entrepreneur needs to see that lenders and investors follow specific guidelines which are designed to insure that they will make money by investing in or lending to a business.

For the vast majority of entrepreneurs, the well-known, high profile means of raising money, such as through venture capital companies or by going public, are not viable options. Their own credit, credit rating, and business history are key factors in obtaining financing for your venture through Small Business Administration (SBA) guaranteed loans and other bank credit. Their ability to tap into a personal network of friends, family, and professional contacts is crucial to raising money beyond what their own personal funds or credit can provide. In all of these cases, there are important considerations such as the potential impact on relationships when family and friends become investors.

When the process of identifying the likely potential funding sources and writing a bankable business plan that addresses their needs and answers their

questions, then the entrepreneur will have greatly increased the likelihood of obtaining the needed financing.

Step # 9: Detail and Explain the Financial Data: How others be convinced to invest in this endeavor?

The accuracy of the financial projections is absolutely critical in convincing investors, loan sources and partners that the business concept is worthy of support. The data must also be scrupulously honest and extremely clear. Since banks and many other funding sources will compare your projections to industry averages in the Risk Management Association (RMA) data, it is important to use the RMA figures to test projections before the bank does. Numbers will be more credible if they compare reasonably to the industry averages.

The actual number crunching portion of the business plan is not the place to talk about pie-in-the-sky hopes for opening an office in every country around the globe or for convincing the U.S. Army that the squid flavored pancakes should become standard fare in all military mess halls. It's the place to discuss how and why certain equipment is needed, how much these items will cost, when the business expects to turn a profit, and how much return and other benefits investors will receive.

The most common reason new businesses fail is simply because they run out of cash reserves. Investors lose confidence in the entrepreneur and the business and become reluctant to make additional investments when projections are not met. Had the projections been less optimistic and the investors asked to invest large amounts in the beginning, they probably would have done so. In most cases, proper planning and more accurate projections could have avoided this problem completely.

A business plan should clearly state the amount of funds you need, how soon they are required, and how long before g investors will be repaid. By the time the entrepreneur has pulled together all the important financial data, he or she will have a clearer picture of how much money they will need to borrow, how much of their own funds they will be able to commit, and the amount of investments they will have to secure. This is also a good time for the entrepreneur to take a crash course in accounting principles or learning how to create spreadsheets on a computer program.

Step # 10: Showing the Entrepreneur in the Best Light: What are his or her qualifications for bringing this plan to fruition?

The talents, experience and enthusiasm each entrepreneur brings to their enterprise are unique. They provide some of the most compelling reasons for others to finance a business. The entrepreneur needs to keep in mind that investors invest in people more than ideas. Even if your potential business has many competitors or is not on the cutting edge of an industry, the qualifications and commitment the entrepreneur demonstrates in the plan can convince others to proffer their support.

The entrepreneur's resume will be included in the separate appendix of exhibits at the end of the plan, so the body of the plan is not the place to list every job he or she ever had or the fact that they were an art history major in college, especially if these experiences have no direct bearing on the ability to start a business. But it is the place to emphasize qualifying skills that may not be readily apparent from a resume.

Say the entrepreneur wants to open the restaurant featuring squid flavored pancakes. Investors won't be initially impressed by a long and successful career as a commercial airline pilot. They may be much more swayed by the fact that from the age of eight to eighteen, he worked after school and weekends in your father's delicatessen. This information has probably never appeared on your professional resume, which stresses the number of flying hours logged, an outstanding safety record and the citations received for the most on-time flights. But having worked for so long and intimately in a family-owned retail food business indicates that the aspiring entrepreneur knows how to supervise cooks, run a cash register, and order perishable foodstuffs in bulk.

Of course, the entrepreneur should not overlook the impact being a pilot may have on his ability to run a restaurant, especially if those skills are not apparent to potential investors. He should stress that you know how to supervise a crew of people working together to make a group experience if not comfortable, at least safe. Pilots have undoubtedly handled dissatisfied or enraged customers. Even that BA degree in art history may enable someone to teach cooks how to make their dishes more appealing to the eye. If the business requires partners or staff, the entrepreneur must be prepared cover the same issues for them.

CONCLUSION

As a normative matter and based on numerous anecdotal experiences of businesspeople and academics in the field of entrepreneurship, it is generally accepted that engaging in formal business plan development is an important precursor to success for entrepreneurs. While long term studies with statistically significant broad samples is not yet available, it is likely that such studies will confirm this finding. If nothing else, it is currently true and will likely remain true well into the future that a formal business plan is a necessary document required by investors, lenders, partners, and government agencies. Yet, the methodology offered to aspiring entrepreneurs and existing business owners for the creation of such plans is often difficult to maneuver and manage.

This article proposes an alternative approach to the Template Model that relies upon detailed outlines, questionnaires, or both. This alternative approach is called the Process Model of business plan development and takes the entrepreneur from the conception stage to more detailed stages of plan development based on the thought processes that I have observed entrepreneurs engaging in. As currently formulated, it has ten stages with the development of detailed financial projections coming towards the end of the process after key strategic, management, and marketing issues have been addressed.

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