

Why Business Plans Don't Get Funded

Your business plan is very often the first impression potential investors get about your venture. But even if you have a great product, team, and customers, it could also be the last impression the investor gets if you make any of these avoidable mistakes.

INVESTORS see thousands of business plans each year, even in this down market. Apart from a referral from a trusted source, the business plan is the only basis they have for deciding whether or not to invite an entrepreneur to their offices for an initial meeting.

With so many opportunities, most investors simply focus on finding reasons to say no. They reason that entrepreneurs who know what they are doing will not make fundamental mistakes. Every mistake counts against you.

This article shows you how to avoid the most common errors found in business plans.

Content Mistakes

Failing to relate to a true pain

Pain comes in many flavors: my computer network keeps crashing; my accounts receivable cycle is too long; existing treatments for a medical condition are ineffective; my tax returns are too hard to prepare. Businesses and consumers pay good money to make pain go away.

You are in business to get paid for making pain go away.

Pain, in this setting, is synonymous with market opportunity. The greater the pain, the more widespread the pain, and the better your product is at alleviating the pain, the greater your market potential.

A well written business plan

places the solution firmly in the context of the problem being solved.

Value inflation

Phrases like “unparalleled in the industry;” “unique and limited opportunity;” or “superb returns with limited capital investment” – taken from actual documents – are nothing but assertions and hype.

Investors will judge these factors for themselves. Lay out the facts – the problem, your solution, the market size, how you will sell it, and how you will stay ahead of competitors – and lay off the hype.

Trying to be all things to all people

Many early-stage companies believe that more is better. They explain how their product can be applied to multiple, very different markets, or they devise a complex suite of products to bring to a market.

Most investors prefer to see a more focused strategy, especially for very early stage companies: a single, superior product that solves a troublesome problem in a single, large market that will be sold through a single, proven distribution strategy.

That is not to say that additional products, applications, markets, and distribution channels should be discarded – instead, they should be used to enrich and support the highly focused core strategy.

You need to hold the story together with a strong, compelling core thread. Identify that, and let the rest

be supporting characters.

No go-to-market strategy

Business plans that fail to explain the sales, marketing, and distribution strategy are doomed.

The key questions that must be answered are: who will buy it, why, and most importantly, how will you get it to them?

You must explain how you have already generated customer interest, obtained pre-orders, or better yet, made actual sales – and describe how you will leverage this experience through a cost-effective go-to-market strategy.

“We have no competition”

No matter what *you* may think, you have competitors. Maybe not a direct competitor – in the sense of a company offering an identical solution – but at least a substitute. Fingers are a substitute for a spoon. First class mail is a substitute for e-mail. A coronary bypass is a substitute for an angioplasty.

Competitors, simply stated, consist of everybody pursuing the same customer dollars.

To say that you have no competition is one of the fastest ways you can get your plan tossed – investors will conclude that you do not have a full understanding of your market.

The “Competition” section of your business plan is your opportunity to showcase your relative strengths against direct competitors,

indirect competitors, and substitutes.

Besides, having competitors is a good thing. It shows investors that a real market exists.

Too long

Investors are very busy, and do not have the time to read long business plans. They also favor entrepreneurs who demonstrate the ability to convey the most important elements of a complex idea with an economy of words.

An ideal executive summary is no more than 1-3 pages. An ideal business plan is 20-30 pages (and most investors prefer the lower end of this range).

Remember, the primary purpose of a fund-raising business plan is to motivate the investor to pick up the phone and invite you to an in-person meeting. It is not intended to describe every last detail.

Document the details elsewhere: in your operating plan, R&D plan, marketing plan, white papers, etc.

Too technical

Business plans - especially those authored by people with scientific backgrounds - are often packed with too many technical details and scientific jargon.

Initially, investors are interested in your technology only in terms of how it:

- solves a really big problem that people will pay for;
- is significantly better than competing solutions;
- can be protected through patents or other means; and
- can be implemented on a reasonable budget.

All of these questions can be answered without a highly technical discussion of how your product works. The

details will be reviewed by experts during the due diligence process.

Keep the business plan simple. Document the technical details in separate white papers.

No risk analysis

Investors are in the business of balancing risks versus rewards. Some of the first things they want to know are what are the risks inherent in your business, and what has been done to mitigate these risks.

The key risks of entrepreneurial ventures include:

- **Market risks:** Will people actually buy what you have to sell? Will you need to create a major change in consumer behavior?
- **Technology risks:** Can you actually deliver what you say you can? On budget and on time?
- **Operational risks:** What can go wrong in the day-to-day operations of the company? What can go wrong with manufacturing and customer support?
- **Management risks:** Can you attract and retain the right team? Can your team actually pull this off? Are you prepared to step aside and let somebody else take over if necessary?
- **Legal risks:** Is your intellectual property truly protected? Are you infringing on another company's patents? If your solution does not work, can you limit your liability?

This is, of course, just a partial list of risks.

Even though *you* may feel that the risks are negligible, potential investors will feel otherwise unless you demonstrate that you have given a lot of thought to what can go wrong and have taken prudent steps to mitigate

these risks.

Poorly organized

Your idea should flow in a nice, organized fashion. Each section should build logically on the previous section, without requiring the reader to know something that is presented later in the plan.

Although there is no single "correct" business plan structure, one successful structure is as follows:

- **Executive Summary:** This is a brief, 1 to 3 page summary of everything that follows in the plan. It should be a stand-alone document, as many readers will make their initial decision based on the executive summary alone. This should usually be written last; otherwise, you have nothing to summarize!
- **Background:** If you are in a highly specialized field, you should provide some background in layman terms since most investors will not have advanced degrees in your field.
- **Market Opportunity:** Describe how businesses and consumers are suffering, and how much they are willing to pay for a solution.
- **Products or Services:** Describe what you do, and how your solution fits into the market opportunity.
- **Market Traction:** Describe how you have succeeded in attracting customers, marketing and distribution partnerships, and other alliances that demonstrate that experts in your market are betting on your solution.
- **Competitive Analysis:** Identify your direct and indirect competitors, and describe how your solution is better.

- **Distribution and Marketing Strategy:** Describe how you will go to market, how you will price your products, etc.
- **Risk Analysis:** Identify major sources of risks, and describe how you are mitigating them.
- **Milestones:** Showcase a strong past track record, and describe key checkpoints for the future.
- **Company and Management:** Provide the basic facts about your company – where and when you incorporated, where you are located, and brief biographies of your core team.
- **Financials:** Provide summaries of your P&L and cash flows, and the assumptions used to come up with these. Also describe your funding needs, how you will use the proceeds, and possible exit strategies for investors.

As stated earlier, there is no “right” structure – you will need to experiment to find the one that best suits your business.

Financial Model Mistakes

Forgetting Cash

Revenues are not cash. Gross margins are not cash. Profits are not cash. Only cash is cash.

For example, suppose you sell something this month for \$100, and it cost you \$60 to make it. But you have to pay your suppliers within 30 days, while the buyer probably won’t pay you for at least 60 days.

In this case, your revenue for the month was \$100, your profit for the month was \$40, and your cash flow for the month was *zero*. Your cash flow for the transaction will be negative \$60 next month when you pay your suppliers.

Although this example may seem trivial, very slight changes in the timing difference between cash receipt and disbursement – just a couple of weeks – can bankrupt your business.

When you build your financial model, make sure that your assumptions are realistic so that you raise sufficient capital.

Lack of Detail

Your financials should be constructed from the bottom-up, and then validated from the top-down.

A bottom-up model starts with details such as when you expect to make certain sales, or when you expect to hire specific employees.

Top-down validation means that you examine your overall market potential and compare that to the bottom-up revenue projections.

Round numbers – like one million in R&D expenses in Year 2, and two million in Year 3 – are a sure sign that you do not have a bottom-up model.

Unrealistic financials

Only a very small handful of companies achieve \$100 million or more in sales only five years after founding.

Projecting much more than that will not be credible, and will get your business plan canned faster than almost anything else.

On the other hand, a business with only \$25 million in revenues after five years will be too small to interest serious investors.

Financial forecasts are a litmus test of your understanding of how venture capitalists think.

If you have a realistic basis for projecting \$50-100 million in Year 5, you are probably a good candidate for venture financing. Otherwise, you should probably look elsewhere.

Insufficient financial projections

Basic financial projections consist of three fundamental elements: Income Statements, Balance Sheets, and Cash Flow Statements. All of these must conform to Generally Accepted Accounting Principles, or GAAP.

Investors generally expect to see five years of projections. Of course, nobody can see five years into the future. Investors primarily want to see the thought process you employ to create long-term projections.

A good financial model will also include sensitivity analyses, showing how your projected results will change if your assumptions turn out to be incorrect. This allows both you and the investor to identify the assumptions that can have a material effect on your future performance, so that you can focus your energies on validating those assumptions.

They should also include benchmark comparisons to other companies in your industry – things like revenues per employee, gross margin per employee, gross margin as a percentage of revenues, and various expense ratios (general and administrative, sales and marketing, research and development, and operations as a percentage of total operating expenses).

Conservative assumptions

Nobody ever believes that assumptions are conservative, even if they truly are.

Develop realistic assumptions that you can support, refrain from using the words “conservative” or “aggressive” in your plan, and leave it at that.

Offering a valuation

Many business plans err by stating that their company is worth a

certain amount. How do you know? The value of a company is determined by the market – by what others are willing to pay – and unless you are in the business of buying, selling, or investing in companies, you probably don't have an acute sense of what the market will bear.

If you name a price, one of two things can happen: (a) your price is too high, and investors will toss your plan; or (b) your price is too low, and investors will take advantage of you. Both are bad.

The purpose of the business plan is to tell your story in the most compelling manner possible so that investors will want to go to the next step. You can always negotiate the price later.

Stylistic Mistakes

Poor spelling and grammar

If you make silly mistakes in your business plan, what does that say about how you run your business?

Use your spelling and grammar checkers, get other people to edit the plan, do whatever it takes to purge embarrassing errors.

Too repetitive

All too often, a plan covers the same points over and over. A well-written plan should cover key points only twice: once, briefly, in the executive summary, and again, in greater detail, in the body of the plan.

Appearance matters

At any point in time, an investor has dozens if not hundreds of plans waiting to be read. Get to the top of the pile by making sure that the cover

is attractive, the binding is professional, the pages are well laid out, and the fonts are large enough to be easily read.

On the other hand, don't go too far – you don't want to give the impression that you are all style and no substance.

Execution Mistakes

Waiting until too late

The capital formation process takes a long time. In general, count on 6 months to a year from the time you start writing the plan until the time the money is in the bank.

Don't put it off. Your management team should be prepared to invest about 500 hours into the plan. If you are too busy building your product, company, or customers (which is arguably a better use of your time), consider outsourcing the development of the business plan.

Failing to seek outside review

Make sure that you have at least a few people review your plan before you send it out – preferably people who understand your market, sales and distribution strategies, the VC market, etc.

Your plan may look perfect to you and your team, but that's probably because you've been staring at it for months.

Good, objective reviews from outsiders with a fresh perspective can save you from myopia.

Overtweaking

You could spend countless hours tweaking your plan in the pursuit of perfection.

A lot of this time would be better spent working on your product, company, and customers.

At some point, you need to pull the trigger and get the plan out in front of a few investors.

If the reaction is positive, and they want to move forward, great.

If the reaction is negative (assuming that the investor was a good fit to begin with), then you may have been heading down the wrong path. Get feedback from a couple of investors, and if a general consensus emerges, go back and refine your plan.

Conclusion

It's a tough investment climate, but good ideas backed by good teams and good business plans are still getting funded.

Give yourself the best possible chance by avoiding these simple mistakes. ■

Akira Hirai is the founder of Cayenne Consulting, LLC, "The One Stop Shop for Startups." He helps venture-fundable companies in the life science, software, and other high-tech industries prepare to raise institutional capital. He can be contacted at akira@caycon.com. For more information, please visit www.caycon.com.

©2003 Cayenne Consulting, LLC, all rights reserved. This document may be freely distributed, provided that it is done so in its entirety and without modification.