

Business plans for entrepreneurs



Introduction

In today's environment, the business plan is the entrepreneur's most important document when setting up a new business. Without the help of a well-designed and well-presented business plan the entrepreneur will find it very difficult to express its business goals or secure financing. Without a business plan, it is almost impossible for someone to take your business idea seriously or even consider investing in it.

Because this thesis is about setting up a business plan for the start-up of a new kind of social network, we will first start with an overview about the concept business plan throughout the literature. In this literature study the term business plan is defined as well as the main functions of the business plan followed by an overview of the typical structure of the business plan. Furthermore, a problem discussion on the topic business plan in the literature is displayed.

In the next part the main focus will lay on the composition of the financial plan.

Subsequently, in the section Location Based Social Network a brief explanation is given about LBSN to give the reader an idea about what the business idea is all about.

An entrepreneur willing to start his own enterprise stands before a lot of obstacles. Building up a company does not happen over one night.

Theoretical framework Introduction

There was a time that entrepreneurs only had to write a letter to propose their business idea and send it to some investors to secure funding.

Nowadays, investors are far more demanding and expect a higher level of expertise and preparation from the entrepreneurs they choose to fund.

Kleiner (2007), a legendary venture capitalist states that when examining a proposal, investors want to see much more than just a good idea and a bright young man or woman: they want to see a business plan showing that the concept has been thoroughly assessed and that the entrepreneur has carefully thought through the issues for taking the necessary steps of taking the idea and transform it into a successful company.[1]

The emergence of the business plan

The term business plan is a word that found its origin during the Second World War period. Back then it was mostly used to define the long term strategies of big firms. The Business Plan was a highly confidential document and was only exposed to a very limited audience. During the 80's the term business plan became more popular and it was then that the first articles appeared discussing the issues behind the business plan. From that decade on, the term business plan was mainly used to indicate the start-up of new and emerging companies. (Karlsson, 2005)[2]. This may be the reason that when the term business plan is mentioned the first image that crosses people's minds is the start-up business, which has not to be especially so because The Ernst and Young Business Guide (1987) points out that even established firms can have formal written business plans to determine or evaluate the accomplishment of business goals.

Definition of a Business Plan

The literature on the topic business plans is awash with information and offers a lot of definitions.. Essentially these definitions have all the same meanings. Abrams & Barrow (2005) define the business plan as a roadmap to the company's targeted destination. Ideally, it enables the entrepreneur to get from the basic business concepts to a healthy, successful business.

Barringer (2009) describe it as a “ written document that carefully explains every internal and external aspects of a new venture” (Barringer, 2009, p. 1)

The format of the business plan

We can distinct three main factors throughout literature from which the BP structure will manly depend. To begin with, the format of the business plan will mainly depend on the purpose for which the BP is elaborated. For instance Barringer (2008) states that a BP established for a start-up company to investigate the feasibility of the venture may somewhat differ from that of a business in expansion that wants to evaluate the accomplishment of the business goals. For example, a start-up firm will not be able to dwell much about the company's history or past successes.

Further, Mason and Stark (2004) argue that whether the entrepreneur is pursuing capital from a bank, a business angel or even a venture capitalist, the format of the business plan should be adapted accordingly.

So we can conclude that depending on the firm's level of development or on what purpose the business plan serves, i. e. to raise capital or for internal

purposes, the emphasis on the topics will be different and the format of BP will vary accordingly.

Functions of the BP

The academic literature provides an abundance of information on the topic: functions of the BP. A single search with Google™ Scholar found 2.3 million hits for terms 'function*' AND 'business plan*'. After going through books and relevant literature we can differentiate internal as well external uses for the business plan.

External purposes

Raising finance:

Most of the time when people think about the reason why a business plan is written, the first thing that pops up in their head is to raise money. It is a fact that most lenders or investors will not put money into a business without first seeing the actual business plan self. If the purpose of the bp is indeed to raise finance, its test will be how much interest it can generate from reviewers in as little time as possible and ultimately how much money it can attract from investors.

Attracting Human Capital

Zetterberg (2004) assigns another interesting external function to the business plan: it can also be used as a tool for attracting human capital. It is not uncommon that a potential employee wants to see the company's business plan before making a decision whether joining or not.

Internal purposes

It seems very unlikely that the sole purpose of a business plan is only that of a fund raising device. Instead, Abrams and Barrow (2005) argue that the business plan has a lot of intrinsic value. The authors of the Business Plan Guide Plan for start-up companies also support this theorem that while developing the business plan has chance to take advantage of two big opportunities:

Marketing plan

First of all, it gives the entrepreneur the opportunity to learn about the industry and the market. When writing a business plan the entrepreneur will have to go to the process of writing a marketing plan. This should give the entrepreneur some valuable insights in who the most important competitors are, who will be his main customer, and also facts about the industry like for example, the market restrictions, market size, and so on.

Internal planning doc.

Secondly it can be used as an internal planning document. Developing a business plan enables the entrepreneur to make the vital business decisions that enable the entrepreneur to focus on his activities and maximize his resources. Immers, while developing the business plan, one will increase the understanding of the many forces that have an impact on your business's success, which in turn will give a stronger sense of control. Like for example understanding the financial aspects of the business including break-even and cash flow requirements.

It is also interesting to note that a business plan can be used within different timeframes.

First of all it can be used to determine the Viability of a Future Business

Allen et al. (2006) describe the BP as “ a plan which can be used to develop ideas about how the business should be conducted.” According to the authors, the entrepreneurs have, by investigating all the different aspects of the venture, such as finance and marketing, the chance to “ make mistakes on paper” rather than making them in the real world and refine their strategies accordingly.

Determine/Evaluate the Accomplishment of the Business Goals

Secondly, Schultz et al. (1987) point out that a business plan can be a retrospective tool, against which a businessperson can assess a company’s actual performance over time. For example, the financial part of a business plan can be used as the basis for an operating budget, and can be monitored carefully to see how closely the business is sticking to that budget.

In this point of view, the plan should be used as the basis for a new plan. After some time has elapsed, the business plan should be re-examined to see if the company has accomplished its business goals and if necessary needs redirection.

To write or not to write a business plan / The relationship between Pre-start-up Formal Business Plans and Post-start-up Performance

The opinions on the topic whether a business plan is a useful document or whether it is more a waste of time are not unanimous throughout the

literature. Despite a lot of researches that have been conducted within this field, the findings from studies that examined whether there is a relationship between the pre-start-up formal business plan and the post-start-up efficiency of the company are not consistent throughout the literature. The word efficiency in this particular circumstance means that it has not been proved that the Business Plan will help a new venture in succeeding.

Some studies claim that they found no relationship between a formal written BP and performance. For example: “ Does formal business planning enhance the performance of new ventures?” (Lumpkin et al. 1998) This study examined the relation between planning and performance among 94 firms of which 54 new entrants. Results suggest that new startup companies who use formal written business plans fail to outperform those who don't.

Of course there are a lot more factors outside writing a business plan playing a role in the future success of the firm. Initially raised capital, experience of the entrepreneurs, used business model, the age of the venture, are just a few to be named. Recent studies conducted by Lange et al. (2007) took all these factors into account and examined whether pre-start up business planning affects the subsequent post-start-up performance of the new enterprise.

Their dataset contained 116 Babson College alums graduated between 1985 and 2003 that started a new business since graduating. From the results of the study it appeared that there is no difference in performance between new ventures that started with a written business plan and those who chose not to write one.

Of course one could argue that the studied dataset has a few limitations. First of all the dataset only comprises ventures started by Babson College which is somewhat limited and will compromise the external validity. It will be difficult to generalize the findings of this study to the rest of the start-up ventures in business world. However, there are benefits at this bounded dataset: the respondents have similar educations. This will limit and take into account the influence from the independent variable, education. On the other hand the taken sample frame is randomized and longitudinal which will benefit the internal validity. This means that the research design allows to formulate a correct answer to the proposed hypothesis.

From their findings Lange et al.(2007) suggest that “ unless a would-be entrepreneur needs to raise substantial start-up capital from institutional investors or business angels, there is no compelling reason to write a detailed business plan before opening a new business.” Instead, the authors suggest that “ entrepreneurs should make financial projections, especially cash flow.”

It means that they should look at expected sales revenue and operating costs including material, labor and capital assets and open their business. That advice implies that they should do business planning but not write formal plans before starting their businesses. Then, if their business grows and needs external funding, they will be able to write a business plan that is more persuasive.

In contrast to the studies from Lumpkin et al. and Lange et al. , some studies have shown that planning does go together with the success and growth of

new ventures. Ford et al. (2003) conducted a study of 800 randomly selected American nascent companies and found a significant positive correlation between the degree of business planning formality and financial results in year 1 and 2.

Liang and Gartner (2005) found, they found that the chances for survival of ventures in an uncertain financial and competitive environment was more likely when they engaged in planning in the early stage of the start-up activities. And that ventures were more likely to continue their activities if they started to plan late in the stage of start-up activities in a certain financial and competitive environment.

For now, we will leave the discussion aside whether causality exists between writing a BP and the success of the venture and move on to asking ourselves why so many entrepreneurs bother to write the business plan.

Many business people or entrepreneurs defend that the time that is needed to produce a formal written BP, would be better spent on pushing the new venture forward instead of writing a plan that no one will read. (Allen 2006)

This might be true if we take into consideration that the venture capitalist or the firms that provide finance to businesses receive piles and piles of business plans and have no time to read them all. In fact, very few entrepreneurs have access to formal venture capital at the moment they launch their businesses. Bygrave and Hunt (2004), for example, estimate that in the US, fewer than one in ten thousand new ventures has the privilege to receive their financial funds of a venture capitalist. This is very rare, especially for the USA which has more than two-thirds of the total

venture capital in the entire world. This means that receiving capital from VC's is by far the rarest form of funding.

So why then go so many entrepreneurs through the process of writing business plans if the main objective of their plan is to secure funding from a venture capitalist and they know that they will almost always come up empty handed? One of the reasons may be that other sources of financial funding such as banks, business angels, equity investors require written business plans too.

Another explanation could be that they write the plan for internal reasons. Although writing a business plan is a very laborious task and it takes typically several weeks to finish it could avoid costly, perhaps disastrous, mistakes later thanks to the planning process that helps the entrepreneur think through things thoroughly. (business plan guide 4 start ups)

Furthermore, it is a fact that if you want your BP to be noticed by investors, the chance is greater if you get a personal introduction, instead of approaching them on your own (Barringer, 2008).

This is definitely the case for all businesses in China. If you want to look for capital, or even if you just want to do business, you will need 'Guanxi'. Guanxi literally means "relationships". Since Confucius set-out the basic relationship rules 2000 years ago this has become the basis for conducting successful business in China. The reality is that the majority of Chinese people won't trust and will not do business with people that are not part of their Guanxi. If you win the confidence of a Chinese business relation, he will be part of your Guanxi network and will be happy to do business or introduce

you to other acquaintances or information sources, thus expanding your Guanxi network. Seligman (2005) points out that it has been generally known for centuries that businesses in China with a widely developed Guanxi network are more successful than those with a limited or no network.

We conclude that is not about having a good or a bad business plan per se to secure finance but more about knowing the right people. This is why startup businesses have the disadvantage over established firms because they may not have such contacts.

Anyway, a lot of authors recommend to do write the business plan because for the internal and external value that lies within the plan. Abrams and Barrow (2005) state that “ a good business plan for a sound business concept not only helps achieving the business goals, it also lets you save time and money by focusing on your business activities, giving you more control over your finances, marketing, and daily operations, and helps you raise the capital you need”. Or as Kleiner (2004), a legendary venture capitalist states: “ Even if you have all the money you need, you still need a business plan. A plan shows how you’ll run a business. Without a plan, you don’t know where you’re going, and you can’t measure your progress.”