

An extract from:

Venture Capital- Chapter Two: The Business Plan

**Dow Schofield Watts LLP**

### **The Business Plan**

The business plan is the first point of contact with the business for the private equity firm. As is common in most situations, first impressions are crucial. It is widely recognised that many good investment opportunities are passed over principally due to quality and content of the original proposal document sent.

It is important to achieve a 'clarity' and 'brevity' which invariably is contained in 'sharp and punchy' documents. 200 pages of narrative, graphs and pictures is unlikely to find a willing reader prepared to write off half a day for a first read. Similarly, a marketing type plan which contains plenty of narrative yet contains one page on the financials and the funding requirement, will find little favour.

The plan must be written in a concise and understandable manner. Because of this, it is sensible to have any document 'proof read' and edited by a corporate finance adviser. The adviser should be experienced in preparing documents to required standard.

The purpose of this plan is to document the business and outline clearly and concisely the investment opportunity being offered.

#### ***Steps to producing a business plan: a guide***

##### ***Step 1: Produce an evidence file***

The evidence file should contain detailed information on the following areas, where appropriate:

- (a) concept and business explained
- (b) market opportunity
- (c) explanation of past track record, financial and otherwise
- (d) product range(s)
- (e) customer profile
- (f) competitor analysis and barriers to entry
- (g) sales and marketing strategy
- (h) sales process from start to end
- (i) production process from start to end
- (j) capital expenditure requirements
- (k) market data and research information
- (l) management team CVs
- (m) organisation charts
- (n) strengths, weaknesses, opportunities and threats (SWOT)
- (o) statutory accounts for the past five years
- (p) copy of the memorandum and articles of association
- (q) copy of any relevant lender facility letters.

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***Step 2: Prepare a financial assumptions file***

Produce a financial assumptions file providing base data for the assumptions used to construct a detailed financial model. The following major areas, where appropriate, will need to be covered:

- (a) sales assumptions by product volumes and unit selling price; in a manufacturing company it is also necessary to relate sales to production capacity and plant utilisation levels;
- (b) the seasonality on the business: on sales, working capital, the impact of holidays and shutdown periods and number of working days in a month;
- (c) relate cost of sales components (eg. direct materials) to sales;
- (d) analyse sales by customer and extrapolate prospects for three years;
- (e) work out required payroll numbers and specific salaries/pay rates to accommodate planned sales;
- (f) quantify and specify overheads by caption, whether direct or indirect;
- (g) review capital expenditure requirements over the next 3 years;
- (h) analyse stock and work-in-progress levels and relate to sales activity;
- (i) analyse debtor and creditor days, historically by month;
- (j) quantify all lender and hire purchase repayment profiles.

The next steps are to produce both the financial model and the written document.

***Step 3: Detailed financial model***

A detailed 3 year financial model is required which is capable of producing monthly profit and loss accounts, monthly cashflow statements and monthly balance sheets. The monthly financial statement should be supported by integrated workings covering each of the major areas highlighted in Step 2. The monthly cashflows will pinpoint peak funding requirements, which will then have to be met by an appropriate funding structure.

***Step 4: Prepare the business plan***

The business plan should be a succinct and stand-alone document, presenting a cohesive case, consistent with the financial model. The business plan should incorporate a summary of the annualised projections and contain a dedicated section on the funding requirement. The document needs to "stand alone" providing readers with sufficient information to evaluate the investment opportunity. It is best to avoid the use of superlatives and statements which are not capable of being substantiated and should chart a cohesive story without unnecessary duplication. At most, excluding the financial section should consist of 20 to 30 pages. The detailed financial model should be supplied separately. A private equity manager is unlikely to invest the time in assessing a larger plan.

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***Example – a suggested contents index***

A business plan should typically contain the following types of section:

*Summary of Proposition* – an introduction to the opportunity and an outline on the business and the funding requirement.

The summary should also given an indication of future and past profitability and make a comment on the experience of the management team. The summary should be a stand-alone section briefly outlining the complete outline story.

*Nature of business* – a description of the industry and an overview of the position of the business in that industry. An assessment of the market and the competition, dependency on any suppliers , customers, intellectual property or technology, the pace of change, the prospects for the industry and the business within it.

*Financial summary.* From the past audited accounts and the detailed financial model give a summary of the following key numbers for the past 3 years and the future 3 years.

*Profit and loss a/c (Extract)*

Turnover

Gross profit

Gross profit %

Overheads

Operating profit

Pre-tax profit

Non-recurring items

Adjusted pre-tax profit

*Balance sheet (Extract)*

Fixed assets

Intangible assets

Investments

Stocks

Trade Debtors

Other Debtors

Trade Creditors

Other Creditors

Finance Creditors

In addition a summary cash flow statement summarising the inflow and outflow of funds is also required. The cash flow statements should clearly show the movements in working capital and historic levels of depreciation and capital expenditure.

It is important that all three statements: profit and loss account, balance sheet and cash flow statement should reconcile. Consequently, if it is important to adjust the past results to exclude exceptional non-recurring items, the adjustments shall be clearly explained and documented in supporting documentation.

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The commentary should describe the historic performance and the key assumptions used to prepare the financial forecasts, Sensitivity analysis showing the effect of varying important assumptions should be shown in a stand-alone appendix.

*Finance required and purpose.* The financial model should be capable of pinpointing funding peaks and troughs and of identifying the optimum capital structure.

#### *Management team*

Given that management is a critical element of any investment assessment, a summary paragraph or two on each senior member of the management team should be included. A factual account of experience and past career is required with the full curriculum vitae kept to the appendices.

#### *Business detail*

This section should provide further depth on the business, providing the detail that gives a complete picture of the business.

- (a) Products and customers
- (b) Market position and competition
- (c) Management and employees
- (d) Premises and facilities
- (e) Fixed assets, production presses and required capital expenditure
- (f) Intellectual property, trademarks, goodwill and other intangible assets
- (g) Contingent liabilities
- (h) SWOT analysis

The business detail section is one that can clearly be supported by pictures and graphs. The key with graphics is to illustrate the text, too many graphics will disrupt the flow of the text.

In the SWOT analysis it is important to be objective on the weakness and threats, since a business proposition which is all strengths and opportunities would imply a lack of realism or understanding of the marketplace.

In summary, there is no right or wrong way to write a business plan. Whilst the plan is written by management it is being read by fund providers, and their needs are the ones to be satisfied.