HOW TO BUILD A BUSINESS PLAN
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There is no real magic in writing a business plan. In fact, it is rather straightforward. The magic is in the due diligence—ensuring that your business venture will succeed because it is supported by solid research and planning.

The business plan, then, is the document that provides the reader with a complete picture of the financial and operational opportunities and challenges of your business—all the evidence to demonstrate that your business will succeed.

This guide below outlines the main components of a business plan.[1]

The Executive Summary

The executive summary is found on the first page following the table of contents. It is a one-page summary of the key business points. Because its quality usually determines whether the reader will continue, the executive summary must be compelling, interesting, and convincing.

The executive summary contains a description of the business (its product or service, method of operations, location, management structure), financial information (sales and revenues figures, number of employees, break-even point), and a closing statement on the purpose of the business plan.

The executive summary of the nonprofit's business plan should include a statement explaining the purpose of the new business. In most cases, it should convince the reader that funding the venture furthers the exempt mission of the nonprofit.

[1] Some of this material appeared earlier in different form in "*Business Planning for Nonprofit Enterprise*," The Nonprofit Entrepreneur – Creating Ventures to Earn Income, edited by Edward Skloot, Foundation Center, New York, 1988.

The executive summary answers questions such as:

- What is the product or service?
- Whom will you sell it to?
- How will you sell it (retail, wholesale, mail order, distributors)?
- Who is the management team?
- How many employees will the business have?
- Where is the business located?
- How will the business operate?
- How does the business relate to your nonprofit organization?
- What are the sales projections for the first three years?
- What is your profit estimate for the first three years?
- When will the business break even?
- How much money do you need, and why?
- How will the money be repaid?

Description of the Business

This section describes the business venture in greater detail. It discusses the product or service, introduces market research results, and identifies unique characteristics that indicate success. The business description makes clear whether the venture is a start-up, expansion, or acquisition. It generally explains how the business will operate and relates the experience of its management team. It projects sales and net income for at least three years, determines break-even, and outlines any capital requirements.

For the nonprofit, the business section should also place the activity in the context of its exempt mission. It should identify why the business will be successful, point to the legal and operating relationship between the nonprofit and the new business, and stress how the business will capitalize on the expertise, talents, contacts, or goodwill of the organization.

The business section answers questions such as:

- What is the product or service?
- Who is the target market?
- Is the business a start-up, expansion, or acquisition?
- Is the business retail, wholesale, manufacturing, service?
- How will the business operate?
- Who is the management team?
- What are the projected sales and net income?
- What are the unique characteristics indicating success?

Marketing Analysis and Marketing Plan

The market analysis shows the reader that there is sufficient demand and willingness to pay for the product or service. Further, the data derived from the market analysis form the basis for the pro forma financial statements.

This section typically begins with a discussion of the "industry" – its size, trends over the last five to ten years, its current status (stable, growing, declining), and key factors that may positively or negatively affect sales (social, demographic, economic, technological).

Next, the analysis focuses on the specific market for the venture's product or service. It examines the size of the market and its growth potential, the characteristics of the typical consumer, and the competition.

The quality of the market analysis for the venture will not differ significantly from that of a for-profit business. The nonprofit must perform a statistically accurate analysis that is replicable and reliable.

Unlike major corporations, most nonprofits do not have a large amount of money to spend on market research. (To be sure, neither does small business.) Therefore, nonprofits must carefully choose the type of research and the researchers that will generate the best information for the dollars spent. For example, the nonprofit might used qualified volunteers or college students to conduct telephone surveys, or it might have a business-school class prepare and conduct a mass-mailing survey.

Of course, this surveying needs to be matched by searches of publicly available data in libraries, research institutions, chambers of commerce, industry associations, and various government agencies (such as the Bureau of Labor Statistics).

Although it is certainly true that "you get what you pay for," and that the quality of the information obtained is usually in direct proportion to the dollars spent, it is also important to consider the research phase in relation to the goal of the nonprofit business. If the goal is modest, perhaps to generate enough revenue to provide gainful employment to a handful of local residents, then the nonprofit may choose to conduct only a small amount of targeted quality research and hope that the results will point to achieving its goal.

The nonprofit should prepare a written marketing plan. The plan is a systematic way of organizing the analysis of the market, the organization's position in the market, and its program for future marketing activities. It describes how the business will attract and keep its customers and its pricing policies in relation to the competition.   It details: 1) the external environment (political, economic, technological, funders/backers, competition); 2) the internal environment (objectives, strengths, weaknesses); 3) problems and opportunities; 4) marketing goals and targets; 5) marketing strategies relating to target segments, competitive position, and the marketing mix; 6) a budget; 7) a marketing action plan; and 8) a monitoring system. This written plan will help nonprofits to choose wisely among options, coordinate activities of different parts of the organization, and anticipate and meet market challenges before they occur.

The market analysis and marketing plan answer questions such as:

- Who is the target market?
- Who is the typical consumer (age, sex, profession, income, buying habits)?
- What is the present size of the market?
- What percent of the market will the business have?
- How will the business expand its market?
- What is the market's growth potential?
- What geographical area will the business serve?
- Who is the competition? What are their strengths and weaknesses? How are they different from the business venture?
- What is the business' competitive edge?
- How will the business advertise and promote its product and service?
- How will the business distribute its product or provide its service?
- Are there any warranties or service policies?
- What is the business' pricing strategy?
- Will the business sell wholesale or retail? Will it have a sales force or use a marketing rep?
- Does seasonality affect the business?
- How will the business handle the public relations function?
- Will the business conduct ongoing research and development?

Management, Personnel, and Organizational Structure

The management section is probably most crucial to the business plan and to its readers. Because it is generally known that a high percentage of business failure is attributed to managerial weakness, the business plan must present a strong management team, and, in its absence, the ability and contacts to obtain key staff.

This section of the business plan discusses executive management. It tells how their background and experience relates to the business venture and how it will make their venture a success. It describes duties, responsibilities, reporting procedures, and decision-making authority. It may discuss their salaries and benefits.

The personnel section of the business plan discusses the current and projected personnel needs of the operation. It does this by describing the number of staff, full-time versus part-time work schedules, the training required, wages, overtime and benefits, and the supply of available workers.

The executive management and personnel discussion will include the relationship between the business staff and the staff of the nonprofit itself. Since several possibilities exist, the choice of organizational structure will also have to be discussed.

One possibility is for the venture (either nonprofit or for-profit) and the nonprofit organization to share management and/or personnel. When this is the case, the business plan must make clear the relationship between the two. For example, it must state which staff will be shared, what percentage of time will be devoted to each, and how staff will be compensated.

When management and personnel are shared, conflict sometimes arises in determining who will work for the business venture (business vs. nonprofit experience), in setting salary levels (business usually has to pay better than nonprofits), and in staff allegiance to one program over another. The nonprofit business that chooses to make use of shared personnel must present a convincing scenario in its business plan. Those that do not intend to share management or personnel must still contend with the perceived and real differences in requisite experience and compensation (because business expertise may be required, higher levels of compensation may be necessary, and this may result in problems among staff).

A second possibility is for the new venture to train and employ the clients of the nonprofit organization. Here, conflicts often arise with respect to salaries, productivity, hours available for work, experience and skills, training, permanence, and consumer acceptance. In many instances there is a trade-off between profitability and the number of clients employed. But this need not be a hindrance so long as the nonprofit business plan reiterates its “dual agenda” and describes how the business anticipates and plans to deal with these issues.

This section answers questions such as:

Management

- What is the business background of key management?
- What is their managerial and operational experience (staff, line)?
- What is their educational background?
- Why will they make the business a success?
- What are the responsibilities of each member of the management team?
- Who performs the planning function?
- Who reports to whom?
- Where are the final decisions made?
- Is there a board of directors or advisory committee?
- What is the overall organizational structure?
- What outside professional services are required, and who will provide them?
- How will management be compensated?

Personnel

- How many staff will the business require in year 1, year 2, year 3?
- What functions will each perform?
- What skills must each have?
- Are the positions full- or part-time?
- Is training required?
- How will personnel be compensated (hourly, wages, salaried, overtime, benefits)?
- Is there sufficient supply of skilled staff available in the marketplace?

Production/Service Delivery

This section describes the specific operational policies and plans for production or service delivery. The main goal of the production/service delivery section is to demonstrate that management understands and has prepared for all the steps that are necessary to produce its product and service.

Because enterprise among nonprofits is still somewhat unfamiliar to many, the production/service delivery section for the nonprofit's business plan should include evidence that indicates some expertise and experience in this area. This does not mean that it is necessary for the organization to have been in business, but rather that it has a track record in processes that are the same or similar to those of the new venture. For example, a social service agency may have ten years of experience in providing counseling services to drug and alcohol abusers, although it never charged a fee for its service. This agency would probably have a good understanding of the marketplace, its clients, and the mechanics of providing counseling services, which translate into marketing, service delivery information, and plans.

The demonstration project is also common among nonprofit organization, and this too may be used as evidence of operational experience. For example, a sheltered workshop that intends to employ its own clients to produce a product for sale in the marketplace might refer to its success in training the disabled to work in an assembly-line fashion.

The business operations section answers questions such as:

- What is the process required to manufacture the item for sale, or to provide the service?
- Which aspects of this process will the business undertake, and which will be provided by others? Who will provide them?
- What are the requirements for fixtures, furniture, machinery or other equipment?
- Will seasonality affect production/service delivery?
- What is the floor plan and structural features of the facility?
- How will the business design new products or develop new services?
- How will the business purchase inventory/supplies?
- How will the business administer quality and cost controls?
- How will the business benefit from the experience of the nonprofit organization?

Financial Plan

The financial plan is the section of the business plan that pulls the sales projections and cost estimates together. The financial plan outlines the following: 1) the business' income, assets required to generate income, and the sources and amounts of funds that are required to finance the assets; and 2) solvency, i.e., the business' ability to cover cash outflows with cash inflows over time. The financial plan is only as sound as the assumptions and the data on which it is based. It is crucial that business projections be comprehensive and accurate. Most financial planners suggest that the authors of plans use conservative financial projections, which underestimate revenue and overestimate expenses. Sound financial projections and well-executed statements are necessary, whether the new venture is capitalized by debt, equity, grants, or some combination of sources, and whether capitalized by a bank, foundation, board of trustees, or other interested party. The same basic information is required for any business plan, regardless of sector.

The form of the financial statements may differ, however, depending on the legal status of the nonprofit's business, i.e., whether it is a for-profit subsidiary or an income-generating program of the nonprofit. The statements may follow private sector accounting principles, fund accounting principles, or a combination of the two. The important point to remember is that the financial plan should take a form that best reflects the nature of the business and its relationship to the nonprofit organization.

Many private sector financial planners would advise a new venture group to hire an accountant to develop the necessary pro forma statements if no one on the team has the knowledge and expertise to do so. Still, the nonprofit organization embarking on a new venture will benefit significantly from the hands-on experience of preparing its own statements.

First, in preparing the statements, the business' planners are forced to understand every aspect of the business and to feel certain that is operations are designed to achieve maximum efficiency. Second, in projecting revenue and expense figures, planners are forced to check all their assumptions and verify all estimates. Third, by playing an active role, the planners are in the best position to explain the business plan and its financial projections when seeking funding. Finally, by immersing themselves in the venture from the start, the business' planners will run a better operation.

The financial plan for a new venture includes three types of pro forma documents. These documents should be prepared for the venture, regardless of whether it is a program of the nonprofit or a wholly owned, for-profit subsidiary:

- Pro forma income statements
- Pro forma cash flows
- Pro forma balance sheets

The cash flow statement should be projected monthly, and the income statements and balance sheets annually for the first three years. In addition, the statements should be accompanied by notes that explain and document the assumptions on which they are based.

A financial plan for a new business also typically includes a statement of financial requirements. This statement sets forth the amount, type, and source of funds required for business start-up, capital equipment, and working capital. It is easily derived from the three primary statements mentioned above.

Cash Flow Statement

The cash flow statement attempts to budget the cash needs of the business, and shows *cash in* and *cash out* on a monthly basis. It shows how much cash will be needed, when it will be needed, and where it will come from. This projection is probably the most central item to the business plan because it shows whether or not there is sufficient cash on hand to run the business.

Every bit of information gleaned from the research is used in the cash flow projection. The statement is constructed in several steps. First, the appropriate revenue and expense amounts are filled in by month. Then, for each month, expenses are subtracted from revenues to arrive at a net cash flow. Finally, the net cash flow for month one is added to the net cash flow for month two to arrive at the cumulative cash flow for month two, and so on across the statement. In essence, it is like accounting for deposits made and checks written in a checking account and calculating a cash balance. Although performing these calculations is easy, determining what numbers to utilize is not. For example, *cash receipts* refer to all cash coming in, including:

- Cash at the beginning of the period
- Cash from the sales of products/services made and received during the month
- Cash from the sales of products/services made during prior months but received in this month
- Cash received from grants, loans
- Cash received from assets sold
- Cash received from equity investment
- Cash received from recovery of bad debts

In projecting sales, for example, it is necessary to apply the research to estimate the total dollar amount of annual sales. If the business is selling fabric, planners must determine the number of yards of each design that will be sold and the price of each yard for each design. Then, of that total annual amount, they must project how much will be sold during each month of the year. They need to know about seasonality, for example, if particular times during the year are better or worse for the sale of a product or service.

The statement will also reflect a sales policy – that is, if prepayment is required, if payment is required with 30 days of the sale, if a partial prepayment is due, if payment is C.O.D., etc. This determines the month in which cash is received.

Although grants and loans may be listed as one of the first items on the cash flow, this item is typically dealt with last. In other words, the entire cash flow was constructed without filling in anything under the grants or loans columns. Then, business planners look at the position at the end of each month (net and cumulative cash flow lines) to see if there is enough income to cover expenses. If, for example, there are negative cumulations, the high point will determine the minimum amount of working capital needed to cover capital expenses.

When the amount of money needed is determined, it is plugged in prior to the month when it is needed, and the entire cash flow is recalculated. (Computer programs such as Excel do this recalculation automatically.) The cash may be in the form of a grant, a loan, the sale of equity, etc. If it is a loan, the statement must reflect a debt service payment under the expense or disbursement part of the cash flow.

Cash disbursements refer to all cash going out, for example:

- New inventory purchased
- Salaries, wages, benefits, taxes
- Rent, utilities
- Fees: accounting, legal, consulting
- Insurance
- Debt service
- New/used equipment purchased
- Transportation, freight
- Advertising
- Provision for past due accounts/bad debts
- Contingency
- Dividends, taxes (for a for-profit organization)

To a certain degree, many expense projections relate directly to sales projections. Managers need to know how much it will cost in inventory, utilities, freight, etc. to make one unit, as well as the number of employees needed to do so. They also need to know how much to spend for advertising and promotion each month to meet monthly sales projections.

Cash or payment is not always received in the month that the sale is made, and sometimes it is not received at all. (This would be an allowance for bad debt or uncollectibles.) On the other hand, expenses such as salaries are incurred in the month that the sale is made. Business planners must constantly remember that they are constructing a monthly cash in/cash out statements and not an annual revenue and expense budget.

Another point to remember is that some monthly expenses may be fixed expenses – that is, expenses that are the same each month because they are not dependent on the number of units produced or gross sales.

And finally, although certain items such as depreciation are expenses, they do not appear in the cash flow because they do not represent an actual outlay of cash. (Depreciation is the process of recognizing the cost of an asset [furniture, equipment] as an expense during each year of its estimated service life.)

The cash flow projection serves several purposes. For one thing, it is an essential component of the business plan, and it shows an investor, lender, or interested party where the business expects to be, on a cash basis, at various points in time.

It also shows the business' planners the same thing. For purposes of the new venture (and the business plan), planners will want to carefully examine the monthly net cash flow, to get their revenue and expenses under control.

Business planers should look carefully at the monthly cumulative cash flow. Are there enough months where revenue exceeds expense to cover those when it does not? It may be acceptable to show one or more negative net cash flow figures as long as the cumulative cash flow figures are positive.

If there is a negative cumulative cash flow figure, this is a warning sign. It means that, according to best projections, there will not be enough cash to cover expenses. Planners will have to go back and reevaluate revenue and expenses, and adjust them. For example, they may inject more capital through a loan or grant (or equity participation if a for-profit). Or, they may want to adjust sales or expense figures. This recalibration cannot be done willy-nilly. Adjustments should be based on realistic, conservative, market-based estimates, and when an adjustment is made in one area, such as sales, it usually means making an adjustment in several other areas, such as variable labor, inventory, advertising, etc.

Cash flow projections should also be used as a budget to course-correct when the operation gets underway. If expenses for a given item increase over the amount allotted for a given month, the business' managers should find out why and take corrective action. And corrective action includes adjusting the entire statement to reflect the new information.

If expenses are less than expected, the business should also find out why. Original projections may have been overestimated, managers may have found a better way to economize, or they may have neglected to pay a bill!

Income Statement

The pro forma income statement measures how successfully management will be able to use the business' resources to predict how profitable the business will be. Also called the profit-and-loss statement (P and L), the income statement projects the difference between net income (sales minus the cost of sales) and operating expenses for a given period of time. Cost of sales are the costs directly attributed to producing the product or service that is sold. For example, they can include such items as raw materials, direct labor, and possibly equipment in a manufacturing business.

In generating pro forma income statements, projections for the second and third year are usually logical extensions of first-year figures. However, it is important to realize that, depending on the business, not all revenue and expense projections will increase by the same proportion each month or year. One type of business may have large start-up expenditures. Another may have a long lead time before making its first sale. Other businesses are seasonal, with the bulk of sales occurring in one part of the year and the bulk of expenses during another.

In still other ways, the bottom line on the income statement over several years is directly related to the type of business venture. Expenses do not always grow at the same rate as sales. For example, in manufacturing some expenses remain relatively fixed over time, such as office and professional services, while others increase with sales, such as payroll and shipping. Looking at the differences between fixed and variable costs in relation to sales helps to illuminate the true sources of expense.

Balance Sheet

The pro forma balance sheet summarizes the resources invested in the business by showing the business' assets and liabilities, and the owners' equity at a given point in time. The balance sheet is divided into two sections. The fist half lists assets – for example, cash, machinery and equipment, and inventory and supplies. The second half lists *liabilities* and *owners' equity*. Liabilities include items such as money due to vendors (accounts payable) and principal and interest due on a loan (debt). Current liabilities are owed to creditors during the first year of operation. Long-term liabilities are those owed for subsequent years. Owners' equity includes investments in the business by partners, stockholders, and others, as well as any retained earnings. In a balance sheet, assets must equal liabilities and owners' equity.

The balance sheet for the nonprofit's business (which either secures its own nonprofit status, or which remains a program of the nonprofit "parent") will show a *fund balance* instead of owners' equity. This is because by law nonprofit organizations cannot sell equity in their operations. In fact, they are "owned" by the states in which they reside. A fund balance, therefore, is merely equal to the difference between the business' assets, and liabilities.

Supporting Documents

This section of the business plan is actually an appendix. It serves to expand on certain aspects of the business venture by supplying the reader with supplementary information that is less appropriate to the body of the plan. For the nonprofit's business plan, this provides an opportunity to include relevant and supportive materials relating to the nonprofit parent.

The supporting documents section, or appendix, generally includes items such as:

- Market data – statistics
- List of product/service offerings
- Floor plan indicating requirements for space
- Capital-equipment list
- Quotes and estimates from vendors
- Rent, lease, or purchase agreements
- Letters indicating a line of credit or loan
- Letters of intent from potential customers
- Letters of support from others in the industry, or from foundations and corporate giving offices
- Legal documents, such as incorporation papers or nonprofit status determination letter
- Annual report and financial statement of the nonprofit parent

Conclusion

Although they are faced with an arduous task, nonprofit organizations wishing to venture into the business arena should not be put off by the rigorous thinking, research, and financial planning involved in preparing business plans. It is through these activities that business planners and nonprofit managers will take meaningful and productive steps towards reaching the social and economic goals of the organizations they serve.