Fundamentals of business planning

In business planning, the journey is just as important as, if not more than, the destination.

Starting a business or purchasing a franchise operation is a major life decision. Like all major decisions, much thought and soul-searching must be undertaken to maximize the probability of success.

Many people, even successful businesspeople, deride the term “business planning” because the process can sometimes be an academic exercise that leads to “paralysis by analysis.” In other words, too much thinking and no execution.

Good business planning should instead be short and to the point: a clear and concise understanding, written or otherwise, of what needs to be done, how it is to be done, who will do it, and when it has to be completed in order to operate a successful and profitable business.

In business planning, the journey is just as important as, if not more than, the destination (the resulting business plan). By going through the process of planning — thinking of what you want to accomplish, identifying the resources you have at your disposal, and analyzing the environment that you have to compete in — you should come to a much better and deeper understanding of yourself, your capabilities, your goals in life, and the industry you want to enter.

If you seriously engage in the process, you significantly improve the probability of succeeding in your venture. Or you could discover that the business you were contemplating might not suit your needs or personality, or that it is not as attractive as it first appeared to be. This could save you the anguish of committing time and cash to a money-losing proposition.

The end result serves as both a communication and guiding tool:

► As a communication tool, it verbalizes to your business partners what your objectives are and how you plan to achieve them, so that you can secure your partners’ support and commitment to your vision.

► As a guiding tool, it provides you with a means to track your progress and a starting point to revise your strategy in the face of the ever-changing business climate. Good business planning is a matter of applying common sense in a business context. There are two major components to the process: the business model and the financial plan.

The business model

The business model is the building block of your business plan. It specifies the value proposition in your business, which consists of two questions:

1) What value can I provide to consumers for the price they are willing to pay?
2) How can I do it profitably?

For example, a restaurant business that sells itself on affordability and value will need to ensure high turnover to generate the volume to offset the lower gross margins expected. The business model adopted would need to reflect this.

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The first step is formulation (deciding what to do — in this case, selling on affordability and value) and the second step is implementation (deciding how to achieve results — or how to ensure high turnover).

**Formulation.** To formulate a business model, it is necessary to evaluate the business environment and resources available. The **SWOT** approach — **Strengths** **Weaknesses** **Opportunities** and **Threats** — looks at both internal and external factors: the strengths and weaknesses of what you bring to the table, and the opportunities and threats in the business environment.

When evaluating the internal factors, you are attempting to identify advantages that you have over competitors that you can capitalize on in your strategy, and shortcomings that you will have to accommodate or address within your strategy.

In identifying opportunities and threats, you will look at the following areas:

- **Industry characteristics.** Size, maturity, seasonality, cyclicity, and obsolescence cycle.
- **Competitive structure.** Who are the major players, how do they position themselves (compete on price, product/service differentiation, etc.), what is market share?
- **Barriers to entry/exit.** Capital intensity, specialized knowledge, regulatory restrictions, patent protection, and customer switching costs.
- **Trends.** Consumer’s taste, demographics.

By understanding your competencies and comparing them to what the market wants and what your competition is doing, you should be able to formulate a strategy of what value to provide, who to target and what format to do it in. You will also be in a better position to decide on the viability and attractiveness of the venture that you are considering.

**Implementation.** Once you know what you have to do, you will then need to decide how to achieve the desired result. This entails decisions on:

- **Organization structure** — who is to do what, information systems required, etc.
- **Organization processes** — standards, performance evaluation and measurement yardsticks, compensation/incentive systems, control systems, human resource policies, etc.

This sets up the organizational infrastructure that will support your business strategy. By aligning your business setup to what you want to do, you ensure a higher probability of success.

Using the same restaurant start-up as an example, in order to achieve high turnover, service must be quick and attentive to ensure tables can be freed up as soon as possible (assuming there is no lack of demand). The correct compensation/incentive structure will help motivate workers toward behaviours and work attitudes necessary to produce the service level needed to achieve a high turnover.

**The financial plan**

The financial plan is the quantitative side of the business model. Having created a viable and attractive business model in the business context, you will need to assess the financial viability of the model. The financial plan can assist in providing answers to these questions:

- What is the capital investment required?
- How much do I have to borrow?
- Can a loan be arranged?
- What is the expected revenue?
- What are the expenses, profit and future capital expenditures required?
- Will the business earn a satisfactory return on the capital invested?
- How will cash flow and credit needs change if sales and/or expenses change?

The basic financial plan consists of three statements: the balance sheet, income statement, and cash flow statement.

**The balance sheet** is a snapshot of the financial state of the business at a point in time. For new businesses, it will show the initial source of capital (funding from debt and equity) and its use (the assets purchased). The balance sheet will tell you how much equity you need to invest to make the deal appeal to the bankers from a leverage standpoint.

**The income statement** details the revenues, expenses, and profit you hope to make over a certain period. Here you have to make key assumptions. These assumptions should be driven by the insights you gained during the creation of the business model. The common mistake made by new business owners is being overly optimistic about the business environment. It is necessary to perform due diligence into the financial aspects of your business to identify a reasonable selling price for your product or service and the true costs of providing that product or service. Always allow for a generous contingency to provide...
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for unforeseen costs or developments that might financially impact the business.

The cash flow statement is similar to the income statement but differs in that the income statement does not differentiate between a credit sale (product is sold but payment is not made until a later date) and a cash sale or an accrued expense (expense is incurred but not paid yet) and a cash expense (cash has been paid upfront).

The cash flow statement deals only in the flow of real cash. Since cash is the lifeblood of a business, keeping a close eye on the cash flow situation of a business is critical. A company with strong profits on the income statement, but which is tardy in collecting its receivables or does not manage its cash flow tightly, may go bankrupt because it may not have the cash to service its obligations.

Cash flow management is especially crucial to a new business since there is no built-up equity to fall back on and the owner may have exhausted his or her resources in starting the business.

Having a projected cash flow statement will assist you in identifying periods of tight liquidity and allow you to take proactive action to reduce this risk. As in the case of the income statement, the assumptions you make must be reasonable when projecting the cash flow of the business. The key is to make reasonable assumptions about the operating cycle, i.e. the average time it takes to sell inventory, to collect receivables, and to pay payables.

The financial plan should be an evolving document. To make it work for you, it is necessary to use it as a reference on a regular basis to track your actual performance relative to plan. Corrective steps can then be taken if there are inefficiencies, or adjustments to the business model can be made if the assumptions were too optimistic to begin with.

The financial plan also allows you to ask “what if” questions. What if sales drop by 25% or increase by 50%? How would this affect my cash holdings? Do I need more credit? This process is called sensitivity analysis. By testing various assumptions, you should get a better understanding of how your business will react to unforeseen changes, and this will allow you to make better, informed business decisions.

Your financial plan is only as good as the assumptions you make. You may want to consult your accountant in preparing your financial plan, or you can use the template found in the TD Canada Trust Business Planner for small business.

Visit your local TD Canada Trust branch and ask for a copy of our business planner, or download a copy from www.tdcanadatrust.com/smallbusiness under the “Tools and Resources” section. Or visit the Government of Canada website for entrepreneurs at www.canadabusiness.ca.

Capital is a scarce resource and getting it can be difficult. Having a well-thought-out and fundamentally sound business model and financial plan will help you gain credibility with bankers and make your search for capital more successful. Having completed the whole process, you will benefit from a firm foundation on which you can confidently launch your business.

For all your small business banking needs, please visit your local branch or www.tdcanadatrust.com/smallbusiness