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part 3 Using your plan

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Essential preparation

> "The only thing we know about the future is that it will be different.
>
> *Peter Drucker*

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Let's start with the output: what should a good business plan look like? We'll get that firmly planted in the brain before we delve into detail. Then we'll consider in more depth what the plan is for and for whom it is written. Finally, we'll look at what you need to prepare prior to kicking off on your winning business plan, in terms of research undertaken and organisation put into effect.

Result

Where do we need to get to? What is the end result of this process? What does a good, winning plan look like and how would that differ from a bad, losing plan?

In short, what is the *essential* outcome?

We'll look at the outcomes under two scenarios:

- A plan for an established business
- A plan for a start-up business.

Let's start with the established business, because it's easier. The business has a track record, both operational and financial, achieved within a historical, recorded context of market demand, industry competition, strategic positioning and resource deployment. Forecasts will be based as much on fact as on judgement.

If you are planning for a start-up, you should still read this section. This is where you're aiming to be in a few years' time, when your start-up has established itself and is poised to attain the next level.

An established business

What does a successful business plan look like for an established business?

We'll take a fictional case study and use it throughout this book. Hopefully it will be a case you can relate to – I'm sure we have all felt the urge now and again to flee the rat race and set up our own business on some idyllic patch of this earth.

This particular piece of British paradise is in Devon, on the gently rolling slopes atop the valley of the river Dart, about 10 miles upriver from Dartmouth. The Dart Valley Guest House and Oriental Spa is owned and run by Dick and Kay Jones, he a former management consultant and she a stress management counsellor of Anglo-Thai heritage.

The business has been operating for three years and has just started to turn a profit. Dick and Kay have secured planning permission to build a 16-bedroom extension and swimming pool – an investment they believe will transform the profitability of the business. But they have run down their personal funds over the past few years and need a further injection of external finance.

In short, they need a backer. So they need a plan. Here's their executive summary (itself précised for the purposes of this book), where, in the equivalent of a mere one and a bit pages of A4, most of the key questions a backer needs to know can be satisfactorily addressed.

Essential case study
The Dart Valley Guest House and Oriental Spa business plan, 2015

Chapter 1: Executive summary

The Dart Valley Guest House and Oriental Spa ('Dart Valley') is a destination with a difference. It is set overlooking a spectacularly beautiful valley in South Devon and yet offers visitors a touch of the Orient in its rooms, cuisine and spa. It has 17 rooms for hire, with spa and restaurant facilities also open to day visitors. It turned over £513,000 in 2014, having grown by 36% per year since 2012, and operating margin is expected to top 20% in 2015. Further investment of £1.05 million in a 16-room extension and a swimming pool is forecast to double sales by 2019 and boost operating margin to 34%. Opportunities to exploit a proven concept outshine risks of cost overrun or slower build-up of occupancy.

Dart Valley has three main business segments – rooms, catering and the spa. Room revenues have been growing fastest, at 45% per year, with spa revenues (20% of total) slower (at 18% per year) due to buoyant custom from non-resident visitors from the start and subsequent capacity limitations, to be eased with the planned Phase II development.

The market for West Country tourism was worth £225 million in 2014 (Source: VisitBritain). Key long-term drivers are the growth in UK population and per capita incomes and the propensity for people to take multiple holidays each year. The main short-term driver since 2008 was the boost to domestic tourism caused by the financial crisis – the so-called staycation effect. This reversed in 2013–14 with the recovery in the economy and overseas holidays, and the market can be expected to remain flat over the next few years.

There are many excellent hotels, guest houses and B&Bs throughout Devon and the West Country. The industry is competitive, with low barriers to entry, with occupancy rates, depending on size and location, improving over time and with the most highly differentiated businesses thriving and enjoying repeat custom. Spa facilities are less widespread in rural Devon than in a big city like Plymouth, but there are good spas to be found in neighbouring Torquay and Totnes. Restaurants offering oriental cuisine, namely Chinese, Thai, Japanese and Vietnamese, can also be found in either one or both towns.

The Dart Valley Guest House is distinctive in two main ways: it enjoys a spectacular location atop one of the most beautiful valleys in England; and it has an oriental theme. The theme is understated, with a hint of the Orient applied to the bedroom decor and oriental treatments available, in addition to standard ones, at the spa. Oriental cuisine is offered in the restaurant, but so too is European fare. The customer is given the choice. In the three years since opening in December 2011, occupancy rates at the Dart Valley have grown from 39% to 56% to 71% and are budgeted conservatively for 75% this year. Restaurant take-up by overnight visitors has risen to 35% of visitor nights and spa occupancy to 26%, both above budget.

Dick and Kay Jones bought the freehold to the premises in 2010 for £715,000, against which they took on a mortgage of £500,000, and spent a further £280,000 of their own funds on renovation. The owners work full-time in the business and employ a staff of three full-time equivalents, with part-time help added as appropriate. Spa professionals are contracted as required.

The business broke even at the operating profit level during 2013, the second year of operations, and achieved a profit before tax of 11% in 2014, budgeted to rise to 15% this year. The owners believe that profitability will be greatly boosted with the planned Phase II expansion, costing £1.05 million for a new building with 16 rooms and an outdoor, heated swimming pool. Overheads, other than financing costs, will rise by 50%, but revenues, once occupancy rates return to today's levels by (conservatively) 2019, will have almost doubled. Operating margin, assuming no change in directors' remuneration, is forecast to reach 34% by 2019 and profit before tax 24%. The speed of growth will continue to yield challenges of cash flow, and the owners will look to their backer to provide the necessary flexibility of finance.

The key risks to this plan are a slower build-up of occupancy, whether caused by a further drop in staycation tourism as economic recovery gathers pace, the opening of direct competition, a peaking of interest in the offering or insufficient awareness, slippage in construction works and the health of the owners – all of which are examined in depth in the plan and found to be containable.

Upside opportunities lie in raising occupancy rates higher than in the plan through marketing focused on exploiting a proven concept, the introduction of new, complementary services or products, lift-off in the spa segment profitability and the acquisition of another site (Phase III), like one identified in the Fal Valley, to replicate the oriental spa concept in Cornwall.

In conclusion, the Dart Valley has established itself as a serious player in the West Country tourism industry, offering visitors something very special. It is now poised, through this expansion, to become the leading player in spa services in South Devon and make healthy profits. Its owners seek a financial partner who shares this vision.

So what makes this a good business plan? First, it is clear and concise. Second, it is coherent and consistent – the storyline hangs together well. Third, it tackles risk. As you will see in Part 2 of this book, a backer is primarily concerned with four areas of risk, all of which seem to be covered adequately in the plan:

- Market demand risk (see Chapter 3) – demand is resilient, having grown counter-cyclically during the most severe economic recession since the 1930s, and now stabilised.
- Competition risk (see Chapter 4) – industry competition is tough, but less so when the offering is distinctive.

- Strategic risk (see Chapters 5 and 6) – Dart Valley has gained share through its distinctive offering and seems well placed to gain further share through this strategically sound expansion.
- Financial risk (see Chapter 7) – the forecast numbers seem consistent with the market, competitive and strategic context.

That's it, then. Dart Valley looks backable, subject, of course, to due diligence.

Essential tip

Your business plan journey should traverse the Seven Cs: a good plan is clear, crisp, concise, consistent, coherent and credible. But above all it is convincing, particularly in its assessment of risk. Its raison d'être is to convince your backer. Remember all Seven Cs, but especially the last.

So what does a bad plan look like? Even a bad plan for a good company?

Suppose Dart Valley's business plan had been drawn up not by Dick Jones, BA, MBA, a former management consultant, proficient not just in managing a business but in strategic and financial analysis too, but by someone dismissive of the need for such a plan.

Here goes.

Essential case study
The Dart Valley Guest House and Oriental Spa business plan, 2015

Chapter 1: A bad executive summary

The Dart Valley Guest House and Oriental Spa is a top location in the West Country for visitors and spa seekers. Revenues are growing fast and the business is profitable.

Devon is one of the major tourist destinations in the UK and the Dart Valley Guest House is the best place to stay.

It is owned by the Joneses and they employ some help around the guest house, spa and gardens.

The owners plan to build an extension and a pool, which will make the business even more profitable. There are no serious risks to this plan, but plenty of opportunities to replicate this model at similar locations in the West Country.

In conclusion, this is your chance to back the Dart Valley and make some easy money.

Convinced? I suspect not. But why not? Have a go yourself at applying some red ink to the 'plan'. I could list scores of things wrong with it, but let's stick to seven, which happen to reflect the headings of each chapter in the business plan, as set out in Part 2 of this book:

- There are no key numbers on sales, growth, sales by segment, margin, market size, market share, etc. Sure, this atrocious executive summary exaggerates to make the point, for most of its ilk have some numbers on sales, profit, etc., but you'd be surprised how many business plans offer no numbers at all on sales by segment (see Chapter 2), let alone on market size or share.
- There is no discussion on market demand drivers, which should underpin any discussion on market demand growth (see Chapter 3).
- Competitors are dismissed, treated as an irrelevance. Not just many, but *most* business plans fail to address convincingly the capabilities of competitors, and very, very few analyse the dynamics of competitive intensity (see Chapter 4).
- 'Dart Valley is the best.' You may be surprised, perhaps horrified, but such broad-brush, unjustified, pub-talk claims are surprisingly commonplace in business plans (see Chapter 5).
- So there are some employees, great, thanks, but how many? (See Chapter 6.)
- How much will the extension project cost, and what will be the subsequent uplift in profitability? (See Chapter 7.)
- What, no risk?! (See Chapter 8.)

That's how not to do it. We'll return to what it is you should be doing in Part 2, but first let's check on what the result should look like in a start-up.

A start-up business

What is the difference in a start-up business plan, compared with that for an established business?

Not much, in truth. The structure of the plan remains the same – an introduction to the business (proposition), market demand, competition, strategic position, resources, financials, risk, and so on – except that it will be set largely in the *future tense.*

What changes most is the level of uncertainty throughout, and in particular in the reception in the marketplace to your business proposition. In a start-up, this market reception is largely unknown. However, it can be researched, assessed and estimated in advance, as you will see in some detail (in Chapter 3).

Let's suppose that Dick and Kay Jones needed to raise external finance for their Dart Valley start-up in 2010, rather than finance the investment through the sale of their London home and a mortgage. Suppose they had to draw up a business plan at the time. Here it is.

Essential case study
The Dart Valley Guest House and Oriental Spa business plan at start-up

Chapter 1: Executive summary

The Dart Valley Guest House and Oriental Spa ('Dart Valley') will be a destination with a difference. It will be set overlooking a spectacularly beautiful valley in South Devon and yet offer visitors a touch of the Orient in its rooms, cuisine and spa. It will have 17 rooms for hire, with spa and restaurant facilities also open to day visitors.

The market for West Country tourism was worth £200 million in 2009 (Source: VisitBritain) and is currently experiencing a 'staycation' boom caused by the deep economic recession. Key long-term drivers are the growth in population and per capita incomes and the propensity for people to take multiple holidays each year.

There are many excellent hotels, guest houses and B&Bs throughout Devon and the West Country. The industry is competitive, with low barriers to entry, but with the most highly differentiated businesses thriving and enjoying repeat custom and high occupancy rates. Spa facilities are less widespread in rural Devon than in a big city like Plymouth, but there are good spas to be found in neighbouring Torquay. Restaurants offering Chinese and Thai cuisine can also be found in both Torquay and Totnes.

The Dart Valley will be distinctive in two main ways: it enjoys a spectacular location atop one of the most beautiful valleys in England; and it will have an oriental theme. The theme will be understated, with a hint of the Orient applied to the bedroom decor and oriental treatments available, in addition to standard treatments, at the spa. Oriental cuisine will be offered in the restaurant, but so too will European fare. The customer will have the choice. We expect the guest house to open in late 2011 and conservatively forecast occupancy rates to grow from 25 to 30% in 2012 to 60% in 2014. Restaurant take-up is forecast to rise to 25% of visitor nights and spa occupancy to 20% in this period.

These forecasts are underpinned by substantial market research and some test marketing. We have compiled a report on the location, offering and resources of a dozen competing three- and four-star hotels in the region and an inventory of competing spa facilities. We have also visited and enjoyably experienced the facilities of two similar 'oriental spas' in the UK, one in London and one in Durham. And we spent two days talking to visitors in the Torbay area, armed with a clipboard and questionnaire, and found that 82% of those currently staying in similarly positioned and priced accommodation would be happy (and 37% 'very happy') to give a concept like Dart Valley a try.

We have an offer to purchase the freehold to the premises for £715,000 and plan to spend £240,000 on conversion and renovation to 17 bedrooms with en-suite bathrooms, a new kitchen and spa facilities – including an outdoor spa tub, a sauna/steam massage shower, two treatment rooms and a meditation room. We shall work full-time in the business and employ a staff of three full-time equivalents, with part-time help added as appropriate. Spa professionals will be contracted as required.

We plan to keep a tight control on operating costs, such that operating profit breakeven can be achieved at 40% occupancy and net profit breakeven at 55%. We forecast that the latter should be achieved by 2014, with net profit rising to 5–10% beyond that. The speed of growth will yield challenges of cash flow, and we shall look to our backer to provide the necessary flexibility of finance.

The key risks to this plan are insufficient custom, with occupancy falling below even the 40% breakeven, slippage and/or cost escalation in renovation works, the opening of direct competition and the health of the owners – all of which are examined in depth in the plan and found to be containable.

The main upside opportunity lies in raising the scale of this venture in a Phase II. If we can gain planning permission, the construction of 12–16 extra rooms in a purpose-built extension, along with an aesthetically harmonious outdoor swimming pool, would permit a greater contribution to site overheads and result in much higher profitability. We plan to commence the planning application as soon as the Phase I renovation work is underway.

In conclusion, the Dart Valley can become a serious, profitable player in the West Country tourism industry, offering visitors something very special. We seek a financial partner who shares this vision.

Apart from the future tense, what's the main difference? You spotted it. It's the additional paragraph 5, where you have to convince your backer that this is not just a punt, but an investment grounded on some *painstaking and rigorous market research.*

We'll return to the market research you need for a start-up later (see Chapter 3).

Need

What is the purpose of a business plan? Why do you need it? Who's it for?

Some guides devote pages to all the possible permutations in answer to those questions. That's a waste of time. The *essential* answers are straightforward:

You need a business plan to obtain backing. It is written for your backer.

It's as simple as that. If you are in need of backing, for whatever reason, a business plan is essential. And you'll craft that plan to address all the key issues likely to be raised by that backer.

You may need backing because you are launching a start-up. Or your company is set for a lift-off in growth. Or it is facing rough times and needs a cash injection.

In each case you need backing, so you'll need a business plan. Of course it can be more complicated than that, but only a little. Here are some purposes worthy of special mention:

- For a start-up
- For raising equity finance
- For raising debt finance
- For board approval
- For a joint venture partner
- For the sale of the business
- For differentiating from a project plan
- For use as a managerial tool.

Let's look briefly at each of these purposes in turn.

A business plan for a start-up

This is not essentially different from a business plan for an established business seeking growth finance. The chapter headings will be the same, but, as you will see in Part 2, special additional questions will need to be addressed – for example, the identification of prospective customers, the crafting of a distinctive value proposition, a pilot survey and the assessment of competitive response.

The business plan for a start-up will be tailored according to whether you are seeking equity or debt finance, but that is the same for an established business (see below).

A business plan for raising equity finance

Your backer is an investor. They look for a return on their investment – as high a return as possible with as little risk as possible. Investors place as much emphasis on opportunity to exceed plan as the risk of falling short of plan. Each chapter of your plan will be written with that in mind, exploring upsides creatively but realistically.

A business plan for raising debt finance

Your backer is a banker. They look to earn fees on the transaction and interest on the loan extended. They want assurance that your business will generate sufficient cash to cover interest payments. And bankers want some form of guarantee, some security, that they will get their money back, all in one piece, at the end of the loan period.

And remember this: your banker may not make the decision. That may be for the bank's credit committee members and they won't meet you. They won't have the benefit of hearing your upbeat version of the future.

They will just examine a cold document, your business plan. So you had better address all the downsides and convincingly dismiss them. The credit committee won't be remotely interested in the upside – that won't benefit them one penny. They only want to know what could go wrong, with what likelihood, and what you will be able to do to mitigate the damage once things have gone wrong.

The whole tenor of a business plan for a banker will be different from a plan written for an equity investor. You will be conservative, cautious and risk averse. Forecasts must be readily achievable. Risks to such unambitious forecasts must be extremely unlikely.

I worked in an investment bank for a number of years and had many a memorable session with credit officers. One thing never ceased to amaze me. No matter how conservative you are in your downside case, the credit officer will always go a shade or two more conservative – no matter how unlikely. So be prepared, and well-armed with the counterargument.

A business plan for board approval

The majority of business plans fall into this category. You can imagine the scene in the boardroom a month or two beforehand, with the chairman expostulating: 'Good grief, Charlie, you and your team have so many exciting ideas for moving this wonderful company of ours forward – but, you know, I'm a bit confused. Where are we going to aim first? Where are our best bets? Which is the more risky? What could go wrong? What could go horribly wrong? Will we have enough cash to fund all this expansion? We need a plan!'

The circumstances may differ, but the business plan itself, when written for board approval, should be no different from a plan written for an external investor. The board is effectively an investor, albeit of internal cash resources, and should be treated as such.