

Introduction to Writing a Business Plan
Version 1.9



CENTER FOR STUDENT
ENTREPRENEURSHIP

University of Washington - Bothell

Alan Leong
With
David Miller
David Thomson
&

Numerous Entrepreneurial Students and Alums

Version 1.9 first published in 2007

Published by the Center for Student Entrepreneurship
University of Washington, Bothell
18115 Campus Way NE
Bothell, WA 98011-8246

Copyright © Alan Leong, 2007

Note: This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is given with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If you require legal advice or other specialized assistance, you should seek the services of a competent professional

Leong, Alan

Introduction to Writing a Business Plan

Includes references

1. Entrepreneurship 2. Entrepreneurs Workshop I. Title

With a single restriction, permission is granted for others to use this in whole or in part for personal or professional use. The single restriction is this: credit is given to “Alan Leong and Friends” at the Center for Student Entrepreneurship - University of Washington, Bothell.

The Center for Student Entrepreneurship (CSE) has an important mission: to increase the odds of student success. It also recognizes the necessity of supporting entrepreneurial alums, affiliated professionals, and even surrounding municipalities. It offers an array of classes and professional seminars, as well as advising and referral services for student entrepreneurs.

The CSE is loosely affiliated with enVenture: the network for entrepreneurs. More than 2/3 of the network membership is comprised of students and alums. The students and alums have launched over 35 companies, the most are still operating.

Center for Student Entrepreneurship

Alan Leong, Director

Entrepreneurship Fund Trustees

Philip Palm, UBS Financial Services, Trustee Chair

Tom Goos, Image Source

Elizabeth Rusnak, Northwest Business Development Association

Advisory Board

Jenny Hall, Par3 Communications

Christina Jackson, Deloitte Enterprise Risk Services

John Rasmussen, University of Washington, Bothell

Curtis Stevens, Deloitte Enterprise Risk Services

David Thomson, Designer Web

Industry Fellows

Maryel Duzan, Seraph Venture Capital

Dwayne Northrup, Garlic Jim's Pizza

Thomas Clement, Pathway Medical

Bill Valenti, Melodeo Inc.

Entrepreneurship Competition Benefactors

Schwabe, Williamson & Wyatt – Attorneys at Law

Al AuYeung, Partner

Robert Peck, Associate

Jen Jolley, Associate

Friends

David Miller, Biotech Stock Research

Hans Omli, Shoestring Ventures

Steve Handley, Linqware

Eric Mattson, Marketing Consultant

Preface

What? Another “how-to” for writing business plans?! What makes this different?

Although this brochure can be read by any entrepreneurial minded professional, it has a specific audience. This was written especially for students and friends who take courses and seminars from the Center for Student Entrepreneurship at the University of Washington, Bothell (UWB).

It's not meant to be a complete guide, but as a companion to the wonderful book, Art of the Start, by Guy Kawasaki.

Who is included as an entrepreneurial-minded professional? Answer: entrepreneurs and key team members. Entrepreneurs are broadly defined by Kawasaki as:

*Guys and gals...creating the next company;
Brave souls that are birthing new products and services to market;
Saints starting schools, churches, and not-for-profits.*

Why even create a business plan?

You can run a successful business without a business plan, but you will increase your odds of success with a good plan. It's a living breathing thing, never static, always changing.

Your plan will morph, you can bet on it. As they say in the military, *a plan is good until the first boot hits the ground and then all bets are off*. You'll need to be quick or die.

We nevertheless maintain that it's important to do the “planful things”. It's like planning for a huge wedding reception. It never turns out according to plan, but it is absolute suicide, yea sheer stupidity, to avoid creating a smart plan.

As Dwight Eisenhower once said: *Plans are useless, but planning is indispensable*.

Co-Authors

Numerous people have helped in the construction of this brochure. Over the years, David Miller has acted as a co-instructor and advisor to many student groups. His approach to the “magic number” was incorporated in the document. David Thomson has contributed as a student and now as a colleague. During the actual writing of this document, Eric Mattson handed me some of his pearls. Numerous other students and alums have contributed, only a few are explicitly mentioned in the text.

Nevertheless, I controlled the content. Any shortcomings are wholly mine.

Table of Contents

Introduction	1
About Business Plans	1
Business Plan Style	2
The Style Checklist	3
The Five Sacred Elements of a Business Model	4
The Executive Summary and Pitch	6
What is an Elevator Pitch?	6
How do I Start?	8
Presentations	9
Who Presents?	9
The Fishbowl	9
Hell Nights	10
The Marketing Plan	11
The Magic Number	12
Wisdom	13
Marketing Section Style Tips	15
Marketing Checklist	16
The Financial Model	17
How Will You Make Money?	17
Cash Flow is King	17
Financial Drivers	19
Milestones & Tasks	20
Return on Investment	21
Financials Checklist	22
Advisory Boards	23
Charity and Community	24
Business Competitions	25
Last Tips	26
References	27

Introduction to Writing a Business Plan

V1.93

This condensed guide was originally written for our workshop for Entrepreneurs – to assist with business plan creation.

Introduction

Your business plan should be a persuasive story about the value of your proposed venture. Moreover, it should be easy to read. Your reader may have a Ph.D. in physics, but that's still no excuse. Your document must combine graphics, tables, and prose so that complex ideas are understood by the village idiot.

About Business Plans

I'm often asked: what should go into a business plan? What's the overall guideline?

You're trying to persuade your readers that you are proposing an excellent business - worthy of endorsement and/or investment. "To persuade" doesn't imply a fast-talking sales job. "To persuade" refers to a "courtroom setting". You are providing a story that presents the facts for proving your case. Like a master attorney, you will tailor the plan to your specific audience.

You should distinguish between a brief versus a detailed business plan. The brief business plan states the case for why the business should be pursued. It can be under 10 pages. The detailed business plan should contain detailed operational and contingency planning; it's your company playbook. An excellent brief plan is often harder to write. *I could have actually submitted a report that was under 5 pages, but I didn't have the time to write it!*

	Brief	Detailed
Executive Summary	Less than 1 page	1-2 pages
Purpose	Persuade investors and decision-makers	Internal company roadmap
Market Description	Primary customer, <i>Addressable</i> market	Detailed description of customer segments
Operational Plans	Sketchy, Key parts	Detailed
Financials	Income, Cash Flow, Key metrics	Income, Cash Flow, Balance Sheet
Overall page length of main body	8 – 15	40-250

Business Plan Style

Tip 1: Don't blindly follow a template.

Over the last two years, our group reviewed over 30 business plans. We knew which plans followed a template. The clues were obvious and these plans were obviously terrible.

For example, each plan will contain a section devoted to competitive analyses. The very next section will contain a SWOT. This is boring repetition.

We have *examples at the course website*; each is different. This is because each plan tells its own story. *Do you really think a template can create a great story?* A plan for a restaurant should look different from a Web 2.0 business. *You master the story, don't let a template master you!*

Tip 2: Copy the best *parts* of another plan.

If you examine the executive summary for Echospace, the graphical display of information is excellent. You may want to adapt the graphics, but you should still tell your own story. By the way, the Echospace document is really an extended executive summary, and not a business plan (no matter what the authors claimed).

Tip 3: Your plan should reflect the 3 Cs: Clear, Concise, and Compelling!

Guy Kawasaki had a great way to organize your plan. Executive Summary, Problem, Solution, Business Model, Underlying Magic, Marketing and Sales, Competition, Team, Projections, Status and Timeline, and Conclusion. These are the topics that can also be used for a Power Point pitch.¹

Tip 4: Diet!

Get your executive summary into a page or less. If you can't, there's a problem. Can you condense each section to a single page? You can build from there as necessary.

Tip 4a: Compel! (Seduce!)

You are a storyteller, not an envelope stuffer! You must stoke interest with your very first paragraph. How do you choose among different books in the bookstore? We're the same way. A weak summary, a boring first paragraph, and then we *toss the plan into the can*. The Art of the Start is *seduction*: yours and theirs.

¹ You'll see these sections on p. 51f, but you'll see a slightly different grouping in Kawasaki's blog. Use whatever makes sense – remember Tips 1 & 2!

The Style Checklist

___ Does it have a compelling pitch? Do you want to keep reading after the first paragraph?

___ Do you want to keep reading after the executive summary?

___ Does it tell a good story?

___ Can an idiot understand it?

___ Is it free of glaring stupidities that make you question the intelligence of the authors?

___ Does it pitch a clear value to the primary customers?

___ Does it make a compelling case for success?

The Five Sacred Elements of a Business Model

Your business model is your business in a nutshell. When Kawasaki says *business model*, he usually means *financials – how you make money*.² When we say it, it's the whole undivided kit and caboodle, including the money.

We have listed the five elements that must be answered in any pitch or plan. From pitch to plan, you must present a clear and convincing model. This also comprises your second checklist.

___ Unique Product or Service

You must tell us what is *unique*. Academic journals and books debate: "Should you be first to market?" Your instructors think it's an irrelevant question for entrepreneurs.

You should always be first to market.

If you're an exact duplicate of an already existing competitor in your niche, you're doomed. Your offering should be different. The "unique" element(s) might seem small - e.g. beer batter pizza crust instead of plain crust - but it may be a winning distinction.

___ Target Customer(s)

Who are they? What is their size? Why them? Segments? Who is competing for their money and attention? You must know thy customer. Don't talk only to your friends.

___ How will you reach your customer?

How will your customers know about your product or service? Where will they purchase it? How will you distribute it? Can you truly reach enough of them to sustain your business? You should be wise about what moves your customer to purchase. Is it a pain? Or is it a sought-after luxury?

___ How will you make money?

Subscription model? One-time purchase? Pay per use?

You should show us when you expect to be profitable and how you won't run out of cash. We expect at least income and cash flow information. In most cases, you should deftly show the key financial driver(s). For example, for Jimmy's Weekly Newsletter, you should relate the # of subscribers to your approximate profit margin and net income.

² On p. 14-15, Kawasaki seems to align his concept of a *business model* closer to the 5 sacred elements.

If you're a non-profit, you still need to be financially sustainable; in addition you'll need to show that you're efficient and unique at solving a problem.

___ Who the hell are you?

What qualifies your team to pull this off? Are there missing holes? How will you fill it? *Don't try to impress us by overdoing it.* Be sensible. For example, your instructors don't employ *full-time* bookkeepers or accountants. That's financial stupidity.

The Executive Summary and Pitch

Your executive summary must contain all 5 sacred elements of the business model. If you work it, you can get all five elements into a single paragraph. If the summary doesn't make the readers salivate nor hyperventilate, then they'll never read about your great model, great product, and great team.

End of story.

It may also help to think of a catchy sentence that describes the heart of your business. For example: "We aim to create the Nordstroms of used clothing: upscale clothing, attractive prices."

You may evoke familiar images, or tell a story. In other cases, one key piece may say it all: "85% of our target customers want to adopt the product and are willing to pay *more than our suggested retail pricing*".

What is an Elevator Pitch?

An elevator pitch is exactly that: if you got into an elevator, could you provide a compelling summary of the business before you hit the destination floor? You should have a 30 second version and a 2 minute version.

It gives you the mighty power to learn fast. Almost no one will read a entire plan, almost everyone will listen to your 30 second pitch.

This is an exquisite art that should be part of every business professional's toolkit, but this isn't easy. Which is harder? Explaining a business within 15 minutes or within 30 seconds?

The Advanced Pitch

The pitch should explain the essential elements (see the section "5 Sacred Elements") while hooking listeners with a compelling story. You might appeal to experience. You might sound poetic, like Bill Clinton or Jesse Jackson.

Your Personal Mantra

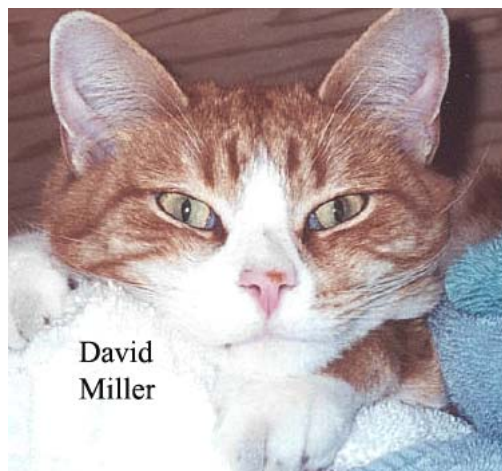
Guy Kawasaki, we love you. He's so right and so is Tom Vu. Tom is one of the young entrepreneurial lights in our group. You must revise your pitch until it's compelling *even to you*.

If you can't find a way to be compelling then you must consult your two bull-shitake detectors: the inner detector and the outer detector. Your outer detector comprises your trusted group of stakeholders and experts (see section on "Board of Advisors").

On the other hand, if you continually come out emotionally flat, then perhaps you really don't feel your idea is compelling. You need to take a hard look at your inner bull-shitake detector. Don't worry. Most successful entrepreneurs have questioned his or her insanity. This should be motivation to improve or morph.

How do I Start?

Our group doesn't agree on how to start writing the plan, but I'll try to summarize the main points within each view.



Pitch then Plan	Plan then Pitch
<p>“Write this down: A good business plan is an elaboration of a good pitch; a good pitch is not the distillation of good business plan. Why? Because it's much easier to revise a pitch than to revise a plan.” (Guy Kawasaki, Tom Vu)</p> <p>Think of your pitch as your outline, and your plan as the full text. How many people write the full text and then write the outline?</p>	<p>Whoever heard of making a pitch without making the plan? If these morons would have the discipline to write a plan, then we'd see better elevator pitches.</p> <p>We see lots of magical handwaving because these moronic pitches are built with no substance. It's substance abuse.</p> <p>Just say NO! Create the plan, THEN create the pitch.</p>
Customers Interviews, Then Financials	Financial Model, Then Customers
<p>Some idiots spend hours to create a single excel cell that no one believes. Want to find great ideas that excite you? Talk to your customers! Want psychosis? Create a financial model without talking to your customers first!</p>	<p>Many stupid ideas come from wild inspiration after talking to the customers. Want to appear smart? Do your model first! Want stupidity? Talk to your customers without creating a full model in advance!</p>

I believe that the default is to pitch or demo to potential customers before building the detailed financials. Remember, you'll morph. Nevertheless, there are exceptions in which you should tinker with the financial model first, especially where the customer demand is well known and fairly constant. You are thus trying to exploit inefficiencies in how services are delivered to a specific (underserved) market niche.

Presentations

In his blog, Guy Kawasaki suggested a really good way to organize your presentation:

1) Executive Summary; 2) Problem; 3) Solution; 4) Business Model; 5) Underlying Magic; 6) Marketing and Sales; 7) Competition; 8) Team; 9) Projections, Status and Timeline; and 10) Conclusion.

Ten slides for 10 topics.

You don't have to exactly follow this format, but you get the point. Be clear, concise, and compelling.

Who Presents?

Kawasaki also said that the CEO should do the pitch, that one person may do the entire presentation. While we agree that the CEO should take on major portions of the presentation, we don't advocate one person doing it all. *At least one or two slides should go to someone else.* This allows the major presenter to reorient themselves to the audience and make any crucial adjustments.

It's about the presentation speech, but it's also about establishing body language. You should practice the movement as well as the speech to project "presence".

In the early going, you should also present for the same reason you should pitch: to get better - faster.

The Fishbowl

Your team is the fish in a bowl. You're persuading an audience that you have a compelling proposition. In return, the crowd gives feedback or raises questions. You may gather your own audience, or you can ask an intact group (e.g. The enVenture Network for Entrepreneurs). In the workshop for Entrepreneurs, your team is required to fishbowl at least once, maybe twice.

Here are some quick tips:

1) Never say: *That's a stupid question* – You can score some serious style points if you can gracefully and intelligently answer the stupid questions. You will get them.

2) Engage the audience before and after the presentation – Entrepreneurship is a code word for *networking*. If you have the chance, introduce yourself, and have a ready smile and engaging personality.

3) Take notes during the Q&A – First, no question is truly stupid. It may reflect your presentation. On the other hand, you'll receive advice that hits the gamut. I've heard professors gang up and take a zillion years to describe one obscure grammatical nit. You should still copy down a few comments and then provide closure by repeating what was stated. It helps to defuse the attacking speaker.

Hell Nights

The workshop ends with a week of hell nights. During hell nights, your team will be assigned a "booth". All teams will compete for the hearts and minds of class visitors in a carnival atmosphere. Visitors will be given play money. You are pitching your business and at the end of the round, the visitors will spread their money around like an investment.

The carnival lasts 20 minutes and the winning team earns the most dollars. After the carnival round is over, then your team must seek out feedback from visitors. The alums are happy to give you feedback.

On the first night, teams are typically a bit shy. On the second night, all hell breaks loose. Teams exude confidence and have markedly improved their approach.

This year, the winning team(s) receives prizes and also instantly wins the right to present before the large audience. Last year, there were over 200 people in attendance. You may invite your friends and family to hell nights.

The Marketing Plan

Great concepts die with poor marketing or poor sales. Everyone agrees with this, but almost every student avoids it. We therefore pitch this commandment to all:

Thou shalt talk to thy customers!

Even before your survey, you should talk informally with your potential customers. More often than not, you'll end up morphing your idea. I *promise* that your business idea will improve. If you saw no improvement, then you haven't really talked nor listened to your customers.

	Traditional	Magic Number	Wisdom
Main Question Answered	Who is <u>my</u> customer?	Can I survive?	What will compel a purchase?
Research Method	Surveys, interviews, census data, location analyses, competitor analyses	Advertising & distribution costs, Dumpster diving	Observations and Interviews
Main Deliverable	Market Strategy	Advertising Strategy	Sales Pitch - Customer Value Proposition
<i>Other Interesting Deliverables</i>	Segmentation, Psychographics, Competitor analyses, Product pricing.	<i>The Magic Number</i> , Marketing budget	Customer psychology, Answering the Ultimate Question.

You can use a traditional marketing text or consult one of our excellent marketing professors for help. We'll discuss two interesting ways to focus your entrepreneurial market research: the magic number versus wisdom.

The Magic Number

This is a fantastic way of centering your market research efforts: what will it cost to acquire customers?

You can use the magic number to help answer: can we survive? Will it be smaller than the profit per purchase? Will we create enough cash flow? What advertising strategy should be employed? What marketing budget is required?

Every good marketing plan must answer the following 5 magic questions:

- 1) How many people do you need? (# of Customers needed to make money)
- 2) How many people are there? (Market Size)
- 3) How many touches are needed? (Frequency)
- 4) What is your conversion rate?
- 5) What is the cost to acquire each customer?

If you've answered the five magic questions, you can derive your "magic number":

The Magic Number: An Example

How many people are there? (target market) 10,000

How many touches are needed? (frequency) 3

What is your conversion (hit) rate? 2%

Cost per touch? \$1.25

10,000 x 3 = 30,000 pieces

30,000 x \$1.25 = \$37,500 cost per touch

30,000 x 2% = 600 converted customer

\$37,500/600 = \$62.50 cost per customer

Magic Number = \$62.50

Your marketing budget is then easily derived from your magic number:

$$\begin{array}{r} \text{Magic Number} \\ \times \\ \text{How many customers you need} \\ = \\ \text{Marketing budget} \end{array}$$

Wisdom

You can gather a lot of information about your customer: demographics, lifestyle, etc. That's nice, but without wisdom, it's mere information. You must answer the basic questions:

*What will drive your customer to happily make a purchase?
What will actually close the sale?*

This is wisdom.

Eric Mattson says: *Learn to Sell, it's the most important characteristic in business.*

Marketing information is about sociology; wisdom is about anthropology and psychology. It's observing and engaging the customer, and then empathically using it to morph your business. If you're successful, you will have customers that happily hand you their money.

Wisdom and the Ultimate Question

After you've launched the business or provided a reasonable demo, then you should ask the *ultimate question* to each customer:

How likely are you to recommend Company or Product X to a friend or colleague?

In 2006, Fred Reichfeld of Bain & Company (management consulting) wrote an award winning book entitled: The Ultimate Question.

Responses to the "ultimate question" above are solicited on a 0 - 10 scale, with 0 meaning the least likely to recommend and 10 meaning the most likely to recommend. The 0 - 10 scale is required for proper NPS calculation. Responses are then described as follows:

- * Customers rating 9-10 are called promoters.
- * Customers rating 7-8 are called neutral.
- * Customer rating 0-6 are called detractors.

The difference between the percentage of a company's promoters and detractors is the Net Promoter(r) Score (NPS). For example, if 50% of a company's customers respond with a 9 or 10, and 30% respond 0 - 6, the company's NPS would be 20%.

On a 10,000 foot level, this makes sense. You want to make friends and lovers and avoid making enemies and marketing terrorists.

Creating Ultimate Pleasure

This then leads to Alan's ultimate question: *What's the top reason for your score?*

This tells you why you're loved and why you're hated. This is painful, but necessary. If you're initially doing a demo on everyone, then you can expect to be hated. As Kawasaki said: It's better to be simultaneously loved and hated. If you're just "kinda liked" by everyone, then no one will buy.

You can't please everyone, but you want to incite love from your primary customers.

Branding

Your wisdom should be reflected in your branding. We won't get into a discussion about the "how-tos" of branding. There are smart people among your instructors and in the enVenture network.

I will state this: many past student and alumni companies didn't think enough about branding. In fact, I'll daresay that most of your proposed companies are really "branding propositions", even if you're touting a special technology (e.g. vehicle tracking in 2002, wireless broadband to the rural areas in 2001).

When I took a college religion course, I learned that the role of a prophet was to bestow meaning on past or forthcoming events. Without the prophet, the audience would not arrive to a common understanding of events. This is branding. You're bestowing meaning about your product or service that will galvanize your customers. *Be a prophet or you'll lack profits.*

Marketing Section Style Tips

Tip 1: Never say “*I have no competitors*”

You have competitors and if your business makes good profits, you'll soon have copycats. If you think you have none, look at current customer behavior. Where do they currently get their needs filled? Think of potential competitors: who *should* be doing your idea? If you believe you have no competitors, that's because you didn't do your research or because no one believes in your market. Every real market has competition. The second you utter this, smart people instantly know you're really dumb.

Tip 2: “*I have no competitors*” Part II

If you have no competition, the most likely reason is that there's no money to be made. There are billion of people and it's unlikely that all of them completely missed a lucrative niche. You don't want no competition, what you want is bad competition. There's plenty of that out there.

Tip 3: Don't overuse the stinking SWOT

You can have a good biz plan without including a SWOT. That's because it's redundant. When you think about it, your whole plan already presents the SWOT info. If true, then if you use it, you will stink.

Tip 4: Never say “*All we need is 1% of the market*”

Yeah, but does this 1% really need you? You need to answer how you're going to grab this 1%, let alone a single customer.

Tip 5: Seek Gurus

The method(s) of collecting marketing information is fairly standard. You should use them. On the other hand, there are gurus who deeply understand their verticals or are truly brilliant at marketing. Some of these people are downright weird, but the nugget below the noise may morph your business. These folks may not even be traditional marketing types, but *shudder*, socially icky engineers.

Tip 6: Seek sales smarts

A good sales director should often be compensated more than the startup CEO. *Marketing* ≠ *sales*, it's a different mentality. These people are in short supply: good salespersons and good sales managers. Pay attention to this. Keep a rolodex of sales geniuses.

Marketing Checklist

___ Does the plan/presentation clearly identify and describe the customer?

___ Does it avoid psychotic numbers for the addressable market?

___ Does it explain how to reach this customer?

___ Does it express a clear, concise, and compelling value to the customer?

___ Is it expressing wisdom, about what will motivate an actual sale?

___ Does it distill a realistic marketing budget?

___ Does the branding zing? Are the names, logos, customer segment, strategy all aligned?

___ If necessary, has it presented a credible way to reward rainmakers and salespersons?

The Financial Model

We won't talk about how to construct your basic financials. We will talk about what we want in the financials section of your business plan. For basic financials, I personally recommend John Tracy's books. The reference section includes his book for entrepreneurs, but you might prefer one of his other paperback books. Professor Tracy is the celebrated author of the Accounting for Dummies series and the Fast Forward MBA in Finance.

Your financial model should be a beautiful thing: *graphical and compelling*. Nevertheless, it requires that you "account for the details" to support your beautiful arguments.

How Will You Make Money?

This is a central question. You'll have to make money in a way that sustains you, as well as satisfies your customer. This may define your niche. For example, you may offer a subscription model rather than force a customer to make an expensive one-time purchase. You'll be tested on whether you have a *workable* financial model. This will be true for the class, competition, and in real life.

On occasion, there will be a business which presents a unique financial model. Russ Thornton's "Cover My Mortgage" is different. Nevertheless, it's relatively simple and straightforward. *Complex schemes aren't for rookies*.

	Fixed Cost	Cash Flow Pressure	Example
Traditional Storefront	High	Medium to High	Nordstroms, Nado Gelato
Internet Retail	Low	Low	Amazon, AD Performance
Pay per Use	Varies	Low to Medium	Xerox, Flexcar
Subscription / Rental	Low	Low to Medium	Salesforce, Netflix
Order to Cash	Varies	Very Low	Dell
Vertical Integration	High	Varies	Zara
Tuition	High	High	Breaking Point Dance
Merchandise Broker	Low	Low to Medium	LocMont
IT Consulting	Low to Medium	Medium (Initially High)	Serriform, Designer-Web

*Franchising changes the model

Cash Flow is King

For the past 12 years, I've made it a habit to interview small business owners. The small startup goes through different stages than the large corporate behemoth.

What's the number one killer of unsuccessful businesses?

Answer: Cash flow.

Actually, a number of things can kill an unsuccessful startup, but cash flow is usually the final nail.

What's the number one killer of successful startups?

Answer: Cash flow!

Eh? You read this right: *success can kill a startup.*

This happens when the customer demand far exceeds expectation. More supplies need to be ordered. If it's a service, then the company may need to hire and train expensive staff. Startups are already cash strapped. Under this situation, the financial situation becomes a gamble. If something goes wrong, then the unforgiving banks and creditors may kill the startup. Murphy's Law often prevails.

Is profit unimportant? Of course not! *It's important, however, to realize that profit \neq cash flow.*

If you're already a going concern, you might consider maintaining a credit facility or some other method of providing a cash cushion. If you're a startup, you'll need to be creative.

Examples of Cash Flow Doom

Suppose "Rudy's Wine Shop" suddenly meets success and must order 5 times its usual inventory on credit. The restaurants love his wine, but are running such thin margins that they typically pay up to 3 months late. Rudy thinks to himself: *Thank god for the in-store purchases by my retail customers.* Unfortunately, an "accident" unexpectedly requires the city to do a month of road work in front of Rudy's Wine Shop, thus killing in-store traffic.

A young IT consulting group, Saraform, has "one project team" of founders. For a variety of reasons – including increasing customer demand – the company must create another project team. The company must double its size, but is really on the hook for at least three or four times the fixed monthly burn. This is because the founders are willing to starve themselves when cash flow is down, but the new employees need steady paychecks.

Cash Flow Statements: Style Tips

Guy Kawasaki says that he wants five-year financial statements. We want *monthly breakdowns* of the Cash Flow until the company is consistently cash flow positive. After that arrives, the yearly and quarterly summaries are enough.

Why?

You can run out of money, but it's hidden within the yearly or quarterly statement.

Financial Drivers

Where is the primary source of your revenues? What will you drive you to profitability? Do your profit margins rise with increases in your revenue driver? Or does it actually fall?

The primary driver(s) is usually related directly to your customer. For “John’s Monthly Newsletter”, it’s related to the # of paying subscribers. For “Gina’s Internet Laundrymat”, it may be the # of monthly visitors. In Gina’s case, she may also need to portray the # of internet surfers.

We ask for two things that are neatly, even graphically, expressed.

- 1) What are your hypothesized sources of revenues?
- 2) How will increases in your primary driver impact your cash flow and bottom line?

To get a real sense of the impact of your driver, you’ll need to take into account your expenses as well as openly state your assumptions.

Expenses

We often find important expenses have been neglected. You can examine the sample student spreadsheet from Plastic Payments. It will list some typical expenses. In professional consultation services (e.g. pedicure, hair care), you should include the Washington State B&O tax.

Unfortunately, it’s the obscure or special expenses that are the hardest. This comes from deeply understanding your industry and your particular business.

The worst expenses to ignore are those that increase with the business. You may discover that you sustain better margins at selected levels of your primary revenue driver. This may limit the ability to scale.

For example, if you’re running a commercial carpet cleaning business, you certainly can’t serve 500 different customers out of one small office. You need several trucks along with storage for equipment and chemicals. The expenses rise with the number of customers.

A Word about Stupid and Obscure Taxes

There are specific taxes levied on specific businesses. For example, if a caterer rents chairs, which in turn are charged to the customer, the customer must pay for two sets of sales taxes on the rental chairs. Yes, this is approximately 19.7% in sales tax! This is specifically applied to caterers and their customers.

How do these taxes get made? Answer: in a backroom.
How do these taxes get disclosed? Answer: very quietly.

Why does our government do this? Answer: to maintain the budget.

Why does our state government do it *this way*? Answer: *Sigh* I can't answer this.

After enactment, these special taxes may be unknown even to your industry specific accountant! In your research, you may consult an accountant, but also a couple key business owners. You may also consult the RCW (revised code of Washington) and perform a keyword search with your browser.

Assumptions

Kawasaki also had a nifty point: weave a MAT of milestones, assumptions, and tasks. In our case, some of these assumptions must be placed in the financial modeling, preferably in the appendix. For example:

- Payroll taxes/benefits are 30% of total payroll and paid monthly
- Bank fees are 2.5% of 50% of sales
- All sales are considered cash sales

Milestones & Tasks

Kawasaki separated milestones from tasks. We don't think that's always the case. We clipped part of Echospace's layout and it nicely combines the two. You may wish for the layout to complement your discussion on the return on investment.

How Echospace Becomes a Leader

	Technology / Product	Organization / Marketing
<input checked="" type="checkbox"/>	Step 1: Develop the Technology	
	<input checked="" type="checkbox"/> Assemble Development Team <input checked="" type="checkbox"/> Design and Develop the Underlying Technology	<input checked="" type="checkbox"/> Assemble Advisory Board <input checked="" type="checkbox"/> Raise Seed Funding (\$525,000) <input checked="" type="checkbox"/> Build Business Team
<input type="checkbox"/>	Step 2: Develop Applications and Basic API	
	<input checked="" type="checkbox"/> Build Basic Component Driven API (Application Programming Interface) <input checked="" type="checkbox"/> Develop Initial Applications (for test and delivery) <input checked="" type="checkbox"/> Alpha Testing – (Dec., 1999) <input checked="" type="checkbox"/> Beta 1.0 Testing – (Jan., 2000) <input checked="" type="checkbox"/> Beta 2.0 Public Launch – (Feb., 2000) <input checked="" type="checkbox"/> Beta 2.5 External Testing – (Apr., 2000) <input type="checkbox"/> Netscape Launch	<input checked="" type="checkbox"/> Research Marketplace and Competitors <input checked="" type="checkbox"/> Develop Identity (name, logo, colors, etc.) <input checked="" type="checkbox"/> Develop Industry Contacts <input checked="" type="checkbox"/> Contact ISPs to Conduct Beta testing <input type="checkbox"/> Raise Additional Funding <input type="checkbox"/> Find, Secure, and Move into New Office Space <input type="checkbox"/> Hire Additional Staff (development, marketing, sales, organizational, etc.) <input type="checkbox"/> Expand Management Team

Return on Investment

Whether you are using a bank loan, personal funds, or hope to raise money from angels, you should portray the return on the funds. There are two types of returns to document:

- 1) Profitable return on the investment;
- 2) Milestones and Tasks that will be achieved.

The first chunk of money may not be enough to achieve positive cash flow nor profit. You should, however, tell us what milestones or tasks should be achieved. In Echospace's case, the founders were able to tell the investors that *in exchange for X dollars, these milestones will be achieved.*

Financials Checklist

___ Does it present a clean and simple financial model?

___ Does it provide a clear, concise, and compelling look at the financial drivers?

___ Does it provide a sound and compelling argument for a reasonable profit?

___ Can an idiot read the above items and understand it?

___ Does it provide an accurate and concise view of the financial statements?

___ Will the company run out of cash? Is there sufficient cash cushion?

___ Does it provide monthly cash flows until it is consistently cash flow positive?

___ Given the customer segment, does the financial model make sense?

___ Were major expense items missed? Or was it fairly thorough?

Advisory Boards

The Art of the Start covers this well and so we add only a couple additional thoughts:

1) Don't list too many freaking professors on your advisory board

Like it or not, the outside world frowns on too many academics on your board. It makes your plan look like a mere school project. Furthermore, professors are viewed as being removed from the real world. You can, of course, have one professor listed on your advisory board. If you must have more, you should list their non-university affiliation and not their academic title.

The exceptions to this guideline include: a) prominent scientists (related to your product); b) university inventors (of your product); c) accounting professors; d) professors who are “rock stars” in the commercial world.

2) If possible, get a lawyer onto your advisory board

This can be the corporate attorney who assists you with securities issues. You basically want to scare off seedy folks who want to intentionally perform unethical and unlawful things to your company. As a high ranking Veep told one of our Entrepreneurs:

We saw that you didn't have an attorney on your board, and so we're going to do what we want. We know that it will cost you too much to sue us.

Charity and Community

We expect you to include a section that says something like: “If we’re successful, we plan to do X or Y”.

It can involve a myriad of possibilities. The usual, of course, involves donations or matching donation programs. You can also discuss employee release time, or donated service or products towards a certain cause. It should be thoughtful and be something that is personally meaningful to you.

If you win a grant or prize through our Center, then we hope that you someday return the support you received from the alums and friends. You are not obligated to replenish the Fund nor donate to the Center. Nevertheless, the concept of charity and/or community is important.

If you enter the competition, you can put in a line like: “Absent replenishing the fund, we plan to do the following...”

We hope that you will give back in some meaningful way to your community, however you define it.

Don’t be confused about what I’m saying about you. I hate it when some ignorant schmuck says that we’re a Center that appeals to greed. If you have any doubt about our entrepreneurs, look at which alums are active supporters of our University.

We’ll change our world in so many ways: create jobs, create local wealth, support change, and help lift new entrepreneurs to do the same. It’s a virtuous cycle that we can do together.

Business Competitions

You're encouraged to enter the UW-Seattle competition. It's a great way to network and to improve your business plan and presentation. Winning should be a "cherry on top" of the experience. I have a list of tips, but this will be given only through a class lecture.

This May-June 2007, we will reboot the UWB Student Entrepreneurs Competition with a twist. There will be cash awards and prizes available for participants. The cash awards that come through the Center Fund are reserved only for UWB student companies. Teams from other universities are welcome to compete; what's their incentive?

- 1) Bragging rights;
- 2) Shoestring Ventures (plus perhaps some Angels) will potentially make offers to student ventures.

These outside investment groups will work alongside of our trustees to evaluate the plans and presentations, *but will make their own decisions*. It's possible that a team that does not even place in the competition meets the favor of Shoestring Ventures.

Let me describe what the competition might look like (partly based on prior UWB competitions). It's only my conjecture and the Trustees may improve on this.

- 1) Each contestant will submit three copies of a "competition compliant" business plan by May 11, 2007 and sign up for an appointment time with the Trustees
- 2) Each team will have "discussions" with the Trustees in the following week
- 3) Selected teams will advance and perform their Presentation
- 4) Winning presenters will revise and resubmit business plans by May 29, 2007.
- 5) Final Presentation Round, Thursday June 7, 2007. Winners declared.

The final presentation round will feature two or three teams. The final round is in front of a large audience plus a panel of judges.

- 1) Each team gets up to 17 minutes to present and gets grilled;
- 2) Each team leader must give a final one slide, two-minute appeal to the judges, the order to be decided by drawing straws.
- 3) The judges retire, some festivities begin.
- 4) The judges return and announce their decision.

Last Tips

These “tips” were created in 2005, after the Entrepreneurs Workshop teams submitted their first business plans. The instructors got together and made this short list.

1. TELL A SINGLE STORY - Each section should not repeat the same tired lines from the other sections. Do the sections make sense with each other? For example, will the customers be happy to surrender their money in the manner described in the marketing and finance sections? If you don't work together on the paper, a stinking business plan template won't save you. The template actually makes it worse.

2. EVERY GREAT CONCLUSION DEMANDS A GREAT BUILDUP - Marketing numbers, support costs, customer counts, and unit costs on the financials should reflect assumptions disclosed and *defended* in the text portion of your business plan. Saying you'll net X number of customers on Y type of marketing is not good enough. Tell me exactly how your marketing dollars will be spent and make sure it all flows through to the financials.

3. STRATEGIC CONTRADICTIONS - You can't be low cost if you're providing the most expensive and expansive service. You also can't provide “great service” if you only have 2 persons in customer support to serve 5,000 customers. By the way, what makes you so much better than anyone else? Prove that it means something to your prospective customers.

4. REAL STARTUP COSTS - (to breakeven, not just to launch). This requires realistic expectations for how long it will take to actually get stuff accomplished (ship product, construct facility, etc.)

5. BUILD YOURSELF A CASH CUSHION. Recognize that you may be spending all your money in the first week of a quarter and receiving it all at the last week. Will you go broke in the intervening 10 weeks? Not if you have the proper cash cushion.

References

Anderson, Chris. The Long Tail: Why the Future of Business Is Selling Less of More. New York: Hyperion, 2006.

Kawasaki, Guy. The Art of the Start: The Time-Tested, Battle-Hardened Guide for Anyone Starting Anything. New York: Portfolio, 2004.

Kim, W. Chan, and Renée Mauborgne. Blue Ocean Strategy. Boston: Harvard Business School Press, 2005.

Leong, Alan. I Have a Business Idea: My First Steps Bothell, WA: Center for Student Entrepreneurship, 2007.

Leong, Alan. When the Shift hits the Plan. Bothell, WA: Center for Student Entrepreneurship, 2007.

Reichheld, Fred. The Ultimate Question: Driving good profits and true growth. Boston: Harvard Business School, 2006.

Tracy, John, and Taze Tracy. How to Manage Profit and Cash Flow. Hoboken, NJ: John Wiley & Sons, 2004.

Ulwick, Anthony. What Customers Want: Using Outcome-Driven Innovation to Create Breakthrough Products and Services. New York: McGraw-Hill, 2005.