Start me up!

ESTIMATES ARE THAT one in three new small businesses in Australia fail in their first year of operation, two out of four by the end of the second year, and three out of four by the fifth year.

But it should cause no surprise when you consider that only a small number of businesses conduct a formal feasibility study and prepare a business plan before they commence the business: estimates are that only 3 to 5 per cent of Australian small businesses starting from scratch prepare a business plan – that is, know that their business is feasible and have a formal plan to operate that business.

Understanding the common reasons for business failure will help form your plans to avoid these pitfalls.

According to a recent study by the University of Technology, Sydney, commonly cited reasons for business failure are, in order of frequency: financial mismanagement, bad management, poor record-keeping, sales and marketing problems, staffing problems, failure to seek external advice, general economic conditions and personal factors.

A closer look at these findings is instructive. The single largest contributor to business failure is financial mismanagement, responsible for 32 per cent of all business failures. The range of problems that combine to make up financial mismanagement are

2005 GUIDE

No business plans to fail, but many fail to plan. **John Petty** reveals the three-step success strategy to writing a winning business plan.

lack of business experience, cash flow problems, being undercapitalised at the start, excessive private drawings, overuse of credit, no budgets and inadequate provision for tax payments.

Fifteen per cent of businesses fail specifically due to incompetent management largely arising from lack of experience. Among failed businesses, 12 per cent have inadequate or inaccurate records. In some, case records and books are totally absent.

Ineffective sales and marketing problems undermine 11 per cent of businesses. Among the critical problems that fall under this category are poor promotion, inability to cope with seasonal factors and insufficient knowledge of competitors.

Staffing problems, including lack of supervision, are also said to cripple 9 per cent of businesses. Surprisingly, only 3 per cent of businesses fail to seek external advice in times of crises.

Looking at the larger picture, general economic conditions are mentioned in 12 per cent of failures. And personal factors like divorce, illness and changed personal situation ruin 6 per cent of businesses.

Other frequent causes of failure include:

- insufficient sales, too few customers compared to the cost of operating
- poor location and lack of customer convenience
- bad costing, delayed invoicing
- giving too much credit, resulting in bad debts and slow payment
- inventory problems – slow-moving or dead stock and shortfalls
- inability to borrow funds
- poor staff, customer and public relations
- let down by suppliers, inability to obtain raw materials as required
- poor promotion, marketing and advertising causing poor image
- poor quality workmanship, inadequate quality management
- lack of industry or product knowledge, or lack of knowledge of market forces
- poor cash control and pilfering of goods/cash/profits

In most cases, it is a combination of several reasons that ultimately causes the failure. Often many of these factors merge or shade off into one another, leading to something like a chain effect.

Any entrepreneur keen on avoiding these traps should first of all do a feasibility study and then, depending on the results, determine their strengths and weaknesses (SWOT analysis) and draw up a formal business plan.

1. Feasibility study

A BUSINESS FEASIBILITY STUDY is crucial before you start any new venture. It is a necessary stage of fact-finding to assess the potential of your concept for a small business. If the idea is a 'goer', the feasibility study leads to a detailed business case. The feasibility study assesses if, and under what circumstances, the business will work and how successful it could be.

A properly constructed feasibility study will tell you:

- what return, if any, the business will give
- what effort is involved and what actions are required
- what risks are involved
- how deep your pockets need to be, and
- how secure your financial investment will be.

A feasibility study can increase your chances of success or, and this is just as valuable, may prove that your proposed business was never going to work.

A wise approach is to look realistically at how your new venture may go and then halve the projections you make – then see if it is still feasible. Many people starting a business have rose-coloured glasses. Take them off!

What feasibility studies will tell you

The feasibility study will tell you:

- for an existing business, whether the asking price can be justified, or what will the impact be on your existing resources as you fund the new project
- the appropriate amount of funding required in terms of initial capital and cash outlay, how long before the business reaches break-even and then the extent of expected profits and cash flow, if it survives the initial start-up traumas
- the management and business skills needed – any deficiencies you may have and what it will take to address. This exercise will also consider issues like employing, managing and training staff, dealing with customers, pricing and marketing, etc
- the legal issues that must be addressed, the appropriate legal entity, use of patents, trademarks, trade names, business names, contracts, leases, supply agreements, etc.

If you're starting a new project or business, the feasibility study asks the obvious questions:

- Why would customers switch to your business?
- What will you offer (other than lower price) that would draw competitors' customers to you and generate the cash flow you need immediately to open the doors?

Potential revenue

The first unknown in your feasibility study is the level of activity and revenue your business will produce, short and long-term. This affects your income – how quickly or slowly the business will take off (whether it can reach its break-even level) and then go on to sustain your desired lifestyle needs.

The following revenue assumptions will determine the feasibility/success of your business:

Pricing policy: premium or discount pricing? Do you discount to loyal customers? If so, how much?
Competitor reaction: any win will be made at the expense of existing competitors.
Marketing strategies: what programs and commitments are implemented?

Competitors

When you are starting out, you're not the only small business in the marketplace! Any client with whom you do business or any customer who buys your product will have to choose

Feasibility study issues

Don't be daunted by the detail – planning for success will help you achieve it. Think of the feasibility study as a type of insurance that will help you make the right decision including:

For a new business

- Is there a market demand and need?
- Can a market be created?
- What is the level of competition?
- Is the market static or growing?
- How to finance the business?
- Are there any legal requirements?
- What skills are essential? Are they available or can they be acquired?

For an existing business

- Why is the existing owner selling?
- What is the performance of similar businesses?
- How good is the business location?
- How tough are the competitors?
- How do you get to the real figures?

The study can be planned under the following headings:

- potential revenue
- competitors (present and potential)
- business environment
- your competitive business advantage
- estimate of expenses
- cash flow analysis, and
- SWOT (strengths, weaknesses, opportunities, threats)

your business over others. An honest review of your existing and potential competitors is fundamental to success.

Understand what current competitors are likely to do in the face of your new operation that could trigger a price war, special promotional offers, new marketing program or new branding.

Business environment

The general business environment will affect your business, so study that environment for both revenue and expenses.

Economic conditions

- rising or falling unemployment, availability of labour
- inflation
- interest rate movements or exchange rates
- rate of growth in business, particularly your operational area
- business sentiment

Technological impact

- how advanced communications affect the business
- rate of growth in advanced technology

Political and commercial factors

- government regulation or control in your area of expertise or the businesses/organisations you will be dealing with
- rates of taxation or new taxation regimes

A useful list of external aspects to 'keep your eye on' includes:

- competition, old and new
- seasonal conditions (floods, droughts, bushfires)
- interest rates
- inflation
- wages and employment conditions
- availability of finance (e.g. credit squeeze)
- consumer spending/confidence
- taxation policy
- currency fluctuations
- government policies and changes related to import/trade restrictions, trading hours, occupational health and safety
- consumer legislation
- international events and the policies of foreign governments

Your competitive business advantage

Ultimately, your business will succeed if it offers clients a competitive advantage. Competitive advantage is reflected in:

- unique service or product
- personalised service
- better quality
- more favourable price
- availability at short notice or longer operating hours
- convenience

To assess your competitive advantage and whether you can attract and retain sufficient clients, take a clean sheet of paper and draw up two lists:

- why clients would deal with my business
- why clients would deal with another business

This assessment will tell you what it is that attracts clients to your business and will help you formulate suitable plans. It also helps focus on what other competitors do well.

Estimate of expenses

Time to estimate your expenses, both fixed overheads and variable. Determine annual estimates as below.

Major expenses

- accounting/administration
- depreciation on equipment and vehicles
- electricity
- insurance
- interest on borrowings
- motor vehicle expenses
- professional advice fees (legal and accounting, etc)
- promotional expenses (advertising/marketing)
- rent, office costs
- stationery
- subcontractors
- technology set-up and updates
- wages
- other costs

Cash flow analysis

Finally, a month-by-month cash flow forecast will let you see the cash flow and balance the consequences of your forecasts. You must be aware of your cash flow needs before you start.

The headings for annual cash flow analysis on a monthly basis:

Opening cash at bank (OC)

Business receipts:

- cash sales
- credit sales

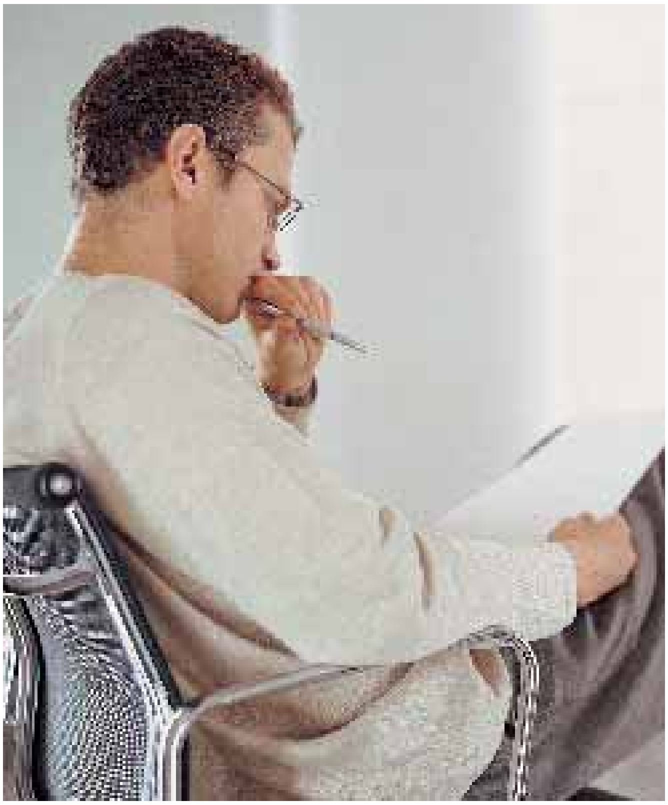
Borrowings undertaken
Owner's funds contributed
Other receipts
Total receipts (R):

Less cash payments

Advertising
Bank charges
Wages/subcontractors
Materials, supplies
Rent
Loan payments
Asset purchases
Owner's drawings
Total payments (P):

Net cash flow (CF) = Closing cash position at bank (CC)
This is the formula: (CC) = OC + R - P

2. SWOT analysis and action plan



THE FEASIBILITY STUDY of your business should allow you to match your initial enthusiasm and optimism with conservative forecasts. If your study shows that the business is destined to be financially feasible, you can open the champagne! The next step is to develop a fuller business plan that includes tactics and strategies to take the business forward.

A business plan includes financial, marketing, distribution, operational and administrative issues that will make the business work. A key feature of your business plan is to show how you will take advantage of opportunities and strengths, overcome weaknesses and head off threats (SWOT analysis).

Strengths

Competitive advantage is that special edge that allows a business to deal with the market and other external factors better than its competitors. Examples include:

- skilled work force
- strong reputation/brand in the market
- quality of service
- excellent product or product concept
- market share
- management skills
- strong financial position

Or, if you are planning to start a business, your strengths might include:

- strong analytical skills
- excellent knowledge of, or profile in the market
- previous business skills
- excellent knowledge of financial management

Weaknesses

A clear understanding of weaknesses within your business will help to form a realistic response to overcoming them. Examples include:

- outdated facilities, equipment or technology
- undercapitalisation/constantly needing funds
- an unstable work force
- poor customer relations

Or if you are starting a new business, your weaknesses might include:

- lack of business knowledge
- lack of management skills
- little exposure to managing quality and suppliers
- little exposure to the management of financials

Opportunities

External forces can change rapidly and management needs to be vigilant and respond quickly. Profitable opportunities may be available to your business through:

- new and changing customer needs
- development of new products, services or territories
- government policies
- changing economic factors
- new technologies
- other factors, including legal issues

Threats

You will need to consider your response to the following:

- actions taken by competitors, including:
  - pricing
  - special offers and discounting
  - promotions
  - strategic alliances (business co-ownership that creates businesses through co-operation of two or more firms)
- changes in customer preferences and buying behaviour
- changes in lease conditions, etc

- economic factors
- shortages of resources, e.g. materials, skilled staff
- legal issues:
  – legislation (national and state)
  – contract law
- developments in technology

Below are two simple tables for effecting a SWOT analysis. Consider the factors above and list the SWOT position of your business. Should you decide that, on balance, you have the right ammunition, go ahead and develop a SWOT action plan. Be honest – really assess and document your weaknesses, as they are what will bring you down. Know what opportunities are out there and the big threats that might attack you! Be realistic – the biggest fools are the ones that fool themselves.

SWOT 2 x 2 analysis

SWOT 2 x 2 ANALYSIS		
HERE and NOW + INTERNAL FOCUS	STRENGTHS	WEAKNESSES
FUTURE + EXTERNAL FOCUS	OPPORTUNITIES	THREATS

Capital requirements

There are important funding issues that must be addressed before you start your business:

- What will your initial capital investment be?
- Will you have enough capital?
- How much working capital will you need?
- How deep do your pockets need to be?

The following expenditures need to be considered as important cash outflows that must be funded from the start. These are the one-off investments you need to make:

- capital costs, including office and factory equipment, tools, computer/software, copier
- other set-up costs such as major consumables, artwork, brochures, signage, stationery, etc
- now add 20 per cent just to make sure your initial estimate is adequate.

Many small businesses fail because they are undercapitalised and run out of cash before the business is established and ongoing operations can provide the funds required.

SWOT 3 x 3 action plan

The SWOT action plan is the next step in your feasibility study. It illustrates the relationship between the current internal features of your business and the future external features with which you meet challenges, grow and develop the business. And this is the reality of what happens in your business: the internal present is challenged by the external future.

The 3x3 table on the right lets you see this interaction and determine if you have the right skills needed to make your business work. The four boxes marked 1, 2, 3 and 4 have very important (and yet different) actions that will determine how successful your business can and will be.

SWOT ACTION PLAN	OPPORTUNITIES 1 .... 2 .... 3 .... 4 .... 5 .... 6	THREATS 1 .... 2 .... 3 .... 4 .... 5 .... 6 ....
STRENGTHS 1 .... 2 .... 3 .... 4 .... 5 .... 6	Actions to do immediately and positively now!	Play to strengths but do it differently
WEAKNESSES 1 .... 2 .... 3 .... 4 .... 5 .... 6	Proceed with caution but address weaknesses	Do or die: must act or else!

3. The business plan

A well-prepared business plan is essential throughout the life of your business, not just before you start. You will need it later on to guide your focus, to prepare for expanding the business or to help implement new directions, technologies or products:

- Before you start your business, a business plan will ensure that the business is feasible and that there is a well laid out blueprint for action. The business plan will cover critical business decisions made at the start, for example, patents, organisational structure, partners, initial debt, etc. It will be geared to the initial funding or capital requirements from a bank or investor.
- Once you are in business, a business plan helps you track how you're going. You may need to include new steps in the plan for one-off grants, accreditations, expansion or strategic changes in direction, new markets, products, further funding requests to banks for either long or short-term funds, or to induce new investors.

Four steps in preparing a business plan

Step 1: collect information

Gather information on your product, business, market, industry, economic climate and anything else relevant.

Step 2: analyse the information collected

Take all information collected and analyse how it will affect the success of the business.

Step 3: form a strategy

Decide how:

- the business will function
- the product will be marketed, including packaging, selling, advertising, etc (marketing plan)
- finances will be arranged, including sales forecasts, budgets, cash flow forecasts, profit-and-loss statements and so on (financial plan)
- the business will operate, including supply sources, equipment, materials (operational plan).

Step 4: prepare the plan

Put all the information together into one consolidated business plan. The plan itself should be:

clear: use simple language, short sentences, tables and diagrams, not too many adjectives
brief: only use essential and useful information, e.g. if asking for finance, tailor the plan to the request (don't put together a lengthy plan to ask for a small loan)
truthful: the business plan should not exaggerate, as others (e.g. your bank) will probably see through the exaggeration and react unfavourably – you need to have a realistic idea
logical: the way the business plan is prepared indicates how the business will be run

Preparing your business plan

Having determined that your business is feasible and conducted your SWOT analysis and SWOT action plan, the next task is to prepare a formal business plan to take you forward.

Contents of the business plan

The following is a sample table of contents. Not all the headings will be relevant to your particular business, and some will be more applicable than others.

- Cover page and introduction
- Executive summary: this is a one to two-page summary of the plan, written to be read as a complete self-contained section
- Mission statement: this is your well thought out statement of purpose, who or what your business is or wants to be; the 'flag on the hill' that you will march towards
- Business description/background: what is the business, competitive position, the market/niche
- Business environment: what's happening in your industry, economy and region
- SWOT analysis and action plan
- Market analysis: preview your market, where you fit and what you know about your customers and competitors
- Marketing plan: your comprehensive guide to marketing ideas and strategies
- Operations: production, logistics and infrastructure

- Financials: this should cover:
  – key financial performance and results
  – profits or projected profits
  – sensitivity analysis
  – cash flow
  – capital requirements
- Human resources/staffing
- Business legalities and intellectual property
- Key success factors: what you must do to achieve success

Cover page and introduction

The cover page should have the following information:
- trading name of your business
- period covered by the plan
- who the plan was prepared for, and the date the plan was prepared.

The introduction sets out the objective of the plan: if the business plan is for financing, the objective would state how much, the purpose of the funds and benefits to the business.

Executive summary

Write this last, as a stand-alone document. Write it as if this is all the reader is going to read. It shouldn't be more than two pages, and it needs to make the reader want to read further into the business plan. Include the high points of the plan, purpose of the plan, significant milestones, key factors for success, financial targets and projected results, and a summary from the action plan.

Mission statement

This is important to help sell your business. A well-considered statement of your purpose and business direction covers what you want your business to be, where you want it to go, the milestones along the way in the immediate term (first 12-18 months), medium term (two to three years) and the long term (three to five years).

Business description and background

This outlines the springboard from which you will proceed, what you are and what the business opportunity is, the nature of the business and past experiences and lessons.

Describe your business concept and unique features, your competitive advantage, any market niche or features that enable you to boast a unique selling point.

Cover the structure and organisation of your business – how it will seize the outlined business opportunity, including an organisation chart showing:
- relationship between departments or key staff
- key responsibilities of each staff member or department
- number of staff in each department
- any planned changes to the organisation during the period of your business plan
- brief résumé of key staff to provide an insight into the quality of management.

Business environment

This is where you address what's happening in your profession or industry, trends and events, as they are relevant to your business opportunity.

SWOT analysis and action plan

This is as discussed in the 'SWOT analysis and action plan' (p25).

Market analysis

Picture your chosen market for the reader. Cover products, services, clients, competitors, distribution, channels – where you fit and what you know. You want the reader to conclude that you know your prospective market backwards, you have done the research.

Marketing plan

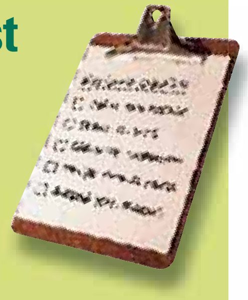
This is a gutsy part of the business plan covering marketing and promotions, selling strategies, pricing, distribution channels and results.

The 'link' between your marketing plan and the resulting business plan is vital. Marketing attracts and retains the customers and ultimately 'drives' the performance of the business.

You can use the 'five Ps of marketing' as a structure to discuss your marketing plans:

- the right **P**roduct
- the right **P**rice
- the right **P**lace (location)
- the right **P**eople
- the right **P**romotional strategy

Marketing checklist



Market research and marketing plan

Define your market
- Who are your present customers?
- Who are your potential customers?
- Who are your major customers?
- What are their buying motives?

Define the size of the market, considering both:
- the domestic and export market

Define the competition
- Who are your main competitors?
- What is their share of the market?
- How will you counter their activities?
- How will your business protect its market share?

Analyse customer needs
- Do they buy on price or quality or services?
- What is their price range?
- What services do you provide?
- How will they purchase them?

Analyse your products
- What is your company's product or products?
- What are your products' advantages (e.g. design, pricing, availability, reliability, service support, etc)?
- What is the production time?

Marketing strategies

Your marketing strategy involves selecting a target market, developing an appropriate mix for each and allocating the resources necessary to achieve its goals.

It is important to understand that the practicality of your business plan is determined to a large degree by how realistic the sales forecast and the supporting marketing strategy are. Four variables shape your marketing strategies for meeting customer needs:
- product features
- quality of product
- level of service to the customer
- price – and this must be profitable to the business

Operations – production, logistics and infrastructure

The operations section of the business plan is the basic nuts and bolts of what to make and deliver. It should cover how you intend to operate the business and how you will organise your operating systems, production methods, capacities, quality control, stock management and asset replacement.

Financials

This key section is used to describe important factors affecting and contributing to the financial performance and profit you aim to achieve.

Cash is important and the financial section must include an analysis of cash flow and include a cash forecast by month for the first year and then quarterly for the next year.

Financial projections

This section sets out your financial projections for the year. These projections will comprise the following and each can carry a brief commentary to highlight key points:
- operating results, profits and losses
- capital expenditure
- cash flow
- balance sheet
- business ratios

Sensitivity analysis

It is difficult to forecast the future. The best way to do this is by developing a number of possible levels of activities (called scenarios) plus a base case or "best guess case", as shown in the table below. This technique is called sensitivity analysis as you consider the sensitivity of each scenario on your profit and cash flow position.

	Best Estimate	+10%	+20%	-10%	-20%	-40%
Sales						
Profits						
Cash flow						
Capital requirements						
Loan payments						
Drawings						
Ratio analysis						

The sensitivity analysis shows that you have addressed the sensitivities that will affect the business, and determined in a logical and structured way, the impact of each on your potential business and the alternative strategies to combat them.

Your sensitivity analysis is critical: you are trying to convince a reader you know your business inside out and that you should be trusted with a loan.

In developing and presenting your financial position and results make certain your figures are arithmetically correct and consistent.

Capital requirements

One of the major deficiencies in small business planning is the failure to properly assess the initial capital requirements. Undercapitalisation is a killer.

Warning

The banks are aware of the dangers of undercapitalisation and that many businesses will underestimate their capital needs.

You must give careful thought to assets and working capital, and the cash flow that will be needed.

The bank will review this situation very closely and lose interest if you have not projected your capital needs correctly.

Human resources/staffing

The ability of your business to achieve its objectives is linked to the effective management of your people.

The people who work for you are your most important asset responsible for:

- achieving your financial goals
- achieving your production goals
- increasing opportunities to sell products and provide services
- increasing their own skills and abilities

In this section, you must give names, qualifications and backgrounds of the owners and senior staff. You should also list any perceived human resources management deficiencies in the business and how these will be resolved, e.g. either by subcontracting or engaging part-time staff.

Human resources checklist

- Do you have productivity incentives?
- Do you recognise achievements?
- What is your training policy?
- How do you involve your employees in:
  - decision-making?
  - planning?
  - job design?
- What is employee morale like? Is it monitored and managed?

Business legalities and intellectual property

Are there any particular legal matters relating to your business? Who owns the intellectual property? What sort of business structure is the business?

Key success factors

You can give your business plan an extra push by including a page of key success factors. This page demonstrates the thoroughness of your plan and the thorough approach you intend to give to all aspects of your business.

Customising your business plan

For a business plan to work, it must be tailor-made for your business. Pro-forma or standard layouts don't work, so customise the contents and guidelines given here to apply to your own business and to your purpose.

Formatting your business plan

Your business plan must look like a quality product and it must give this impression quickly.

Carefully consider:

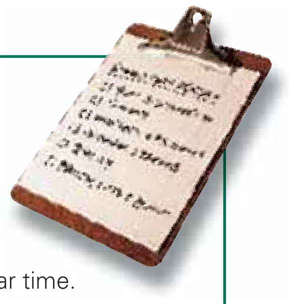
- Appearance
  – choice of paper, its colour and feel, the binding, the cover
- Style of the finished product is important and must be customised to
  – the personal style of the presenter
  – the personal style of the receiver (ask what the bank manager wants)
- Brevity
  – summaries and bullet points are easy to read
  – don't write a long-winded novel or soap opera
  – headings and subheadings increase readability
- Relevance
  – what is said and how it's said must be structured to the objectives of the plan
  – make sure your messages come through loud and clear
- Timeliness
  – highlight time targets and any action plans to be implemented to achieve these
  – the reader will be impressed with your commitment, resolve and determination
- Size
  – this depends on the audience but you can expect your business plan to be a minimum of 15-20 pages

Initial and ongoing business planning

Business planning is not a one-off exercise, but an ongoing business activity. You need to regularly review (say every six or 12 months) and revise your business plan.

John Petty is a lecturer in small business management at the University of Technology (UTS), Sydney, and small business research consultant to Pitchers Partners, Sydney.

Business plan review checklist



Go over your business plan and see if you need to change your plan to suit the conditions prevailing at that particular time.

Goals and tracking
- Have you set your company objectives?
- Have you realistically forecast your potential sales?
- Have you set a detailed budget to achieve those required sales?

Capacity
- Do you have the right staff in skills and in attitude?
- Are you well equipped to physically operate the business?
- Do you have enough staff capacity and a forecast on how they will be used?

Marketing and positioning
- Are you effectively advertising and marketing into your market?
- Are you improving your competitive position?
- How do your prices compare to competitors' and do they match your market niche?

Customers and service
- Are you creating new customers and how?
- Are you retaining existing customers and why?
- Do your staff have good customer service relations and attitude?
- Do you follow up customers (before, during or after sales or service)?

Quality
- Are your staff fully trained in the range of services you provide?
- How do you ensure good quality workmanship?
- Do you use an order or job tracking system and a well presented detailed invoice?
- Do you analyse every sale/job/project and see where you could do better?

Pricing, costs and profits
- Do you have good credit management and control?
- Are your charge rates up-to-date and do you fully detail all costs?
- Do you check your unsold time daily and understand why?
- Are you controlling your expenses?
- Do you have good accounting and budgeting policies/ practices?