PKF FRANCISCLARK
Chartered accountants & business advisers

CORPORATE
FINANCE

EFFECTIVE BUSINESS PLANNING

A practical guide for entrepreneurs, directors, managers and shareholders

Supporting you and your business

Effective Business Planning

A practical guide for entrepreneurs, directors, managers and shareholders

Contents

1 Introduction

"The whole world steps aside for the man who knows where he is going"
Anon

All businesses are run with the aim of meeting certain objectives, which can range from providing a lifestyle business to creating an international giant. Whatever the objective, it is vital to agree and understand the objectives and then plan how to achieve them.

Objective setting is generally known as strategy, whereas the overall delivery system is detailed in the business plan. Business planning is actually a valuable management technique in its own right, but one that is often overlooked. The process makes the business owners and managers:

- see their business objectively;
- assess their achievements (and under-achievements);
- set, or reset, their strategy based on their view of the business' future performance and development; and
- determine the resources available or required to meet the business objectives

It forces them to evaluate the trading environment, understand the competitive threats and consider the economic factors that affect their business.

In practice, it seems that many business owners and managers are not familiar with the planning process and the preparation of a business plan; they may need advice if they are to exploit the full potential of the technique.

People don't plan to fail. They fail to plan".
Mark McCormack

This booklet provides the practical guidance required to prepare a business plan. The first part of the publication (Sections 1 to 3) contains general guidance on the business planning process. The Appendix sets out in detail the contents of a plan to serve as a guide to its preparation and ensure no important area is overlooked.

Why is business planning necessary?

There are many reasons for preparing a business plan - raising finance is the most common reason, or perhaps a Management Buy-Out where a business plan is an important step in managing change.

Inevitably, businesses perform more profitably when they meet their markets well prepared. This does not necessarily mean that profits cannot be achieved without a business plan, but for most companies planning increases profitability and financial stability and helps them develop into stronger long-term performers.

Relying on "gut-feel" and luck is not usually a successful management technique!

PKF Francis Clark

PKF Francis Clark are experts in helping people prepare their business plans; we believe that the business planning process must be led by management rather than their advisers. The management team must "own" their plan; otherwise they will not deliver the planned results.

We add value by acting as an independent "sounding board" and contributing our experience gained from other successful business plans.

For further information, speak to Andrew Killick or Paul Crocker, our Corporate Finance partners, or your usual PKF Francis Clark contact, or visit: www.pkf-francisclark.co.uk/dealmakers

2 Business planning in action

As well as the general benefit of improving the bottom line, business planning can have more specific objectives or may be required for a particular purpose as mentioned above. Different objectives require different emphases in the business plan. However, the business planning process has common features:

- it should be forward-looking and not based simply on past results and practices;
- it needs to take account of the dynamic nature of business and markets and must consider the impact of change;
- the process must review the achievements of the business and measure them against the market; and
- a high level of commitment of time and effort is needed from all levels of management.

This process is a valuable opportunity for senior management to hear the views of junior managers and to agree objectives with them. Unless there is wide involvement, people will not “buy-in” or own the plan.

The business planning process

The process usually begins with the setting of strategic objectives by the owners of the business, detailing their long term objectives and how these relate to the business.

This involves a review and analysis of the business and its market (the “internal” and “external” views), which is generally delegated to the managers who normally deal with these matters.

“Plans are nothing; planning is everything”.

Dwight Eisenhower

The internal review of the business considers its historical and current performance as well as its capacity and requirements for the future. The external review aims to identify trends in the market, both for the business’ products and what competitors are doing and examines product delivery.

However, it is sensible for one person to be responsible for drafting the business plan itself to ensure a clear focus and the same style throughout.

The plan should include the “milestones” by which progress will be measured, including detailed profit and cash flow forecasts.

Once the business plan has been completed, it should be kept under review and the financial projections revised as required. The value of the plan is in keeping as a source of reference - it should be regarded as a document to be developed as a management tool, not a one-off project to be forgotten.

The golden rules of the business planning process

> *“Life is what happens while you are making other plans”.*
> John Lennon

- Business planning is an important step towards profitability.
- Providers of finance will not take you seriously if you do not have a business plan. If you do not know where you are and where you are going, how can they assess your potential?
- Involve all levels of management and work towards a consensus of objectives. It must be owned by everyone.
- Use third party information about your industry and your markets.
- Be prepared to commit time and effort to your business plan.

The final product

Your business plan will reflect the ability, quality and performance of those who produce it. Bankers and other lenders will form a view of the quality of management from the plan. One that includes little critical analysis or is badly written and presented is unlikely to create a good impression of management.

Tips on writing a business plan

CONTENT

- Make business plans interesting to read! “Hit” the reader from the front cover onwards.
- Use the business plan checklist in Section 4 to ensure all areas are properly covered.
- Ensure you portray the quality and effectiveness of management.
- Use independent data. Include all available independent market research in the appendices and summarise findings in the plan. Do not rely on your own perception of the market.
- Identify key assumptions and assess their realism.
- Include sensitivity and risk analysis.
- Ensure consistency of the financial projections with the main assumptions.
- Ensure the mathematical accuracy and conceptual soundness of the financial projections.
- Concentrate on the overall effectiveness of your plan in “selling” your business to financial institutions.

GENERAL

- Ensure your plan meets the needs of its users rather than its writers.
- Obey the ABC rule - accuracy, brevity and clarity, and KIS - Keep It Simple.
- Avoid excessive detail. Try not to exceed 25 pages for the main part of the plan - a reasonable maximum for an intelligent reader to absorb quickly. Put as much detail as possible into the Appendices.
- Avoid jargon. If you must use it, include a glossary.
- Well-designed graphs, charts and tables (especially in colour) can usefully replace large amounts of text. They are also more attractive.
- Avoid presentational gimmicks such as unusual typefaces and page lay-outs, but also avoid a boring page wherever possible - presentation quality is important as long as plans are not too “slick” or glossy as this may present the wrong image.

Remember - it is the management’s business plan and it is management who will have to perform. It is essential that strategies and targets set are realistically achievable.

3 Using the plan to raise finance

The initial review

Your plan is likely to be read and assessed by your immediate first contact, before being subjected to a fuller appraisal. Many are rejected at this stage confirming the importance of first impressions.

Remember that financial institutions and Venture Capitalists receive a large number of business plans each day and give them an initial review fairly quickly. It is essential that your plan stands out in terms of quality of presentation; an excellent executive summary helps to get past this first hurdle.

"Money can't buy happiness; it can, however, rent it".

Anon

The other effective way of ensuring that your plan reaches the right individual in an organisation, and gets read by them, is to use experienced firms such as PKF Francis Clark who have developed appropriate contacts over many years.

Common criticisms of business plans

- No proper executive summary
- Not knowing the audience
- Not being clear what is required from the lender
- Concentration on product rather than the market in which it sells
- Overestimating sales volumes or price
- Underestimating financial requirements, especially working capital requirements
- Financial projections do not tie into the plan
- CVs which do not help in assessing management
- Lack of risk assessment
- Poor sensitivity analysis
- Too long

Meetings

Prospective financiers and bankers will probably wish to visit you to discuss the plan, see your business in operation and begin to establish a working relationship. The initial meeting is an opportunity to test those features of your business that are especially important to the financier, such as:

- "ownership" of the business plan;
- the quality and commitment of management;
- opportunities and threats to the business;

- the operation of the business; and
- the quality of its products and workforce.

This initial meeting is unlikely to result in an immediate offer of finance. Decisions will almost always be referred to a higher level, but a favourable recommendation from the financier you first meet is vital. There may be a series of meetings in which your plan will be closely reviewed.

Investor return

Financiers will also be interested in making a return on their investment. Remember to factor this into the business plan and forecast by making it clear what returns are expected and in the case of Venture Capitalists when and how an exit will be achieved.

Time commitment

Do not underestimate the time required, both to produce your plan and for it to be reviewed by financiers. Lenders are likely to need at least a fortnight for their initial assessment process, sometimes longer.

Financial projections and forecasts

Accountants can get excited about projections but potential lenders are more interested in the overall content of a business plan, including the figures. In assessing the credibility of your projections and financial requirements, they will go through a number of stages:

- identify the key assumptions you have made and assess their plausibility;
- analyse the historical and forecast figures;
- review the outcome of previous forecasts;
- closely scrutinise the basis of revenue projections and the collection of cash;
- assess the serviceability of projected borrowings;
- quantify the gearing and risk attaching to the business and assess the adequacy of your capital contribution; and
- consider how they will be protected if your venture fails and ask what security is being offered.

Financial institutions will be concerned about the possible vulnerability of your projections. Sensitivity analysis should concentrate on the critical assumptions where variation poses a threat to the business. It allows them to assess the "head room" that exists and whether you are able to service proposed borrowings.

"Life is short and so is money".

Bertolt Brecht

Where possible the subject of security should be covered and might include recent property valuations and comments on alternative uses and values for plant and equipment. Where a debenture may be taken, the plan should deal with relevant assets, particularly debtor and stock levels. Check with the lender before valuing property since they may have their own list of approved valuers.

Raising equity

There are strict rules on the distribution of business plans that seek to raise equity for minority shareholdings in limited companies. These mainly relate to the submission of plans to individuals such as Business Angels, and careful legal advice is needed in this area.

Please refer to our "Raising Finance" brochure for more information.

Other important areas

Financial institutions clearly rely on the management team to market and sell the product/service. Your plan should adopt a realistic market driven approach to evaluate future sales that is consistent with past performance, and not dependent on over-optimistic assumptions.

You should be in no doubt that providers of finance will expect to be kept informed of progress in your business. Your existing ability to produce reliable and timely management information in the future will greatly influence their attitude.

The golden rules of meeting the lender's requirements

- Always state early in the plan your actual financial requirements.
- Make sure all management has ownership of the plan.
- Aim to give a good first impression.
- Allow sufficient time for the plan to be appraised.
- Be candid and open when you meet potential lenders.
- Link assumptions, projections and the narrative of your plan.
- Make clear the security on offer.
- Pay attention to management information.

Risks

For any funder or investor, an understanding of the key risks facing the business is essential when appraising a proposition. Often business plans fail to acknowledge these risks leaving the funder/investor to reach their own (potentially misjudged) conclusions.

By presenting a well-considered risk analysis strengthens the credibility of management and also allows you to lead the risk assessment in a direction you want it to go. For each risk an appropriate mitigation ought to be in place that either reassures the funder that it is not a significant risk or details the steps that will be taken to minimise its impact. This section should cover both risks inside the control of management (e.g. operational, financial) and also those outside (e.g. macroeconomic, legislative, foreign exchange).

Restrictions, Disclaimers and Confidentiality

When a business plan is prepared for raising finance it will be sent to individuals and organisations outside the company. As a result it is usual to include various restrictions and disclaimers such as:

- Purpose of the business plan
- Confidentiality of information
- Verification of information
- That funders must make their own enquiries
- Restriction of circulation

The wording on these restrictions is usually provided by your professional advisors and depending on circulation of the business plan, will include wording to meet the requirements of legislation (see below).

Legislative Pitfalls

This guideline is not intended to provide guidance on legislative requirements, such as the Financial Services Act 2000 ("FSMA"). However, there are three particular points to be aware of:

- Under FSMA's restrictions only firms authorised by the Financial Services Authority may issue or approve financial promotions (an invitation to engage in investment activity) which can apply to business plans (which are "non-real time communications") and it is necessary to be familiar with the procedures and exemptions if the business plan is being sent to anyone.
- The main exemption that companies and advisors take advantage of is to ensure that they are only making the offer to high net worth individuals (individuals that have a certain level of investment assets) or sophisticated investors (those that have already made similar investments, are a director of a company of a certain size, or have a professional role in the financial services sector).
- The Public Offer of Securities Regulations 1995 may apply if the business plan is being prepared in relation to offers of shares to the "public". If this is the case a Prospectus could be required and the requirements are onerous.

Advice should be taken if required to ensure any legislative requirements are met.

Appendix 1: Content Checklist

EXECUTIVE SUMMARY
- The purpose of the business plan
- A summary of key points to the plan
  - Background to the business
  - Key selling points
  - Managements experience
  - Financial highlights
- Management's strategy for the business
- Risk areas and how these are mitigated
- Funding considerations (if applicable)
  - Amount of funding required
  - Why funding is required
  - Expected return to funders

BACKGROUND AND HISTORY
- Key stages in development of the business to the present day
- Current ownership structure and funding position
- Industry in which the business operates
  - Background
  - Stage of development
  - Success factors
  - Barriers to entry

PRODUCTS AND SERVICES
- Company's main products and/or services
- Unique selling points
- Product lifecycles and where specific products are in their life cycle
- Major products/services introduced by competitors
- Analysis of profitability by product and/or service
- Research and development (if applicable)
  - Future product pipeline
  - R&D spend
  - Timetable for product releases
  - Licences/regulatory approval required

CUSTOMERS AND MARKETS
- Significant customers and any dependencies
- Spread of customers
- Outline of any contracts with customers
- Customer sensitivity to price, quality and service
- Relationship with customers
  - customer loyalty
  - who in the company has key relationships
- Customer positioning in their market
- Current order book
- Overall marketing strategy
- Pricing strategy
- Distribution methods
- Sales support/warranty arrangements
- Summary of the market
  - Size/Structure
  - Growth to date and future prospects
- Company's market position
  - Market share
  - Strengths and weaknesses
- Competitor responses to company's strategy

SUPPLIERS
- Key Suppliers & spread
- Alternative suppliers for key product components/raw materials/services
- Significant supplier agreements

MANAGEMENT TEAM AND EMPLOYEES
- Relationship between ownership and management
- Brief details of key managers
  - Age/Experience
  - Present role
  - Remuneration
- Relevant achievements of management as individuals and as a team
- Plans to fill vacant roles and rectify weaknesses in the team
- Succession strategy (if applicable)
- Outline of organisation structure
- Brief details about employees
  - Roles
  - Remuneration policies
  - Recruitment and training
  - Union representation (if applicable)
  - Future resource requirements

STRATEGY
- Growth plans
- How growth will be achieved
- How the strategy fits in with existing plans
- The opportunity for the funder including exit routes
- Future opportunities
- SWOT/PEST analysis
- Ensure consistent with the financial forecasts

RISKS
- Acknowledge and summarise key risks to the business
- Highlight potential impact, likelihood and mitigations.

FINANCIAL INFORMATION

Historic
- Analysis of past performance, highlighting non-recurring and 'exceptional' items
- Explanation for fluctuations in turnover, gross margin etc
- Comments on seasonality
- Key aspects of the balance sheet
  - Debtors and creditors days
  - Stock holding period
  - Significant fixed assets & depreciation polic
  - Description of intangibles
- Return on capital employed

Forecast performance
- Key assumptions
- Commentary on assumptions and forecasts
- Overview of trends in forecast performance
  - Profit and loss & Cashflows
- Profit and cash flow drivers
- Explanation in changes in forecast compared to historic
- Anticipated capital expenditure requirements
- Relevant sensitivity analysis

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