MINTZ

What Makes a Good Business Plan?

January 14, 2016 | Article | By **Daniel I. DeWolf**

VIEWPOINT TOPICS

- Venture Capital & Emerging Companies

RELATED PRACTICES

- Venture Capital & Emerging Companies

RELATED INDUSTRIES

The way most businesses are initially funded is by the three Fs. That is, by "friends, family, and fools." After all, who else would provide the initial seed capital to start a new enterprise? But self-funding (or relying on friends and families) will only take you so far in building out your new business.

Clearly, the longer a founder can develop the business without the infusion of outside professional capital the more control and ownership will be retained by him or her. That is why many founders choose to "bootstrap" their enterprise as long as possible. Often founders will max out their credit cards or take out second mortgages against their homes in order to fund their new businesses. Sometimes founders are fortunate to attract wealthy individuals, commonly known as "angels," who can help them with start-up capital. At some point, however, in order for an enterprise to create significant and meaningful value, it will likely need the fuel provided by large sums of capital that is available from professional venture capital investors. But how does one go about presenting the new business to the venture capitalist?

The first thing the entrepreneur must do is create a business plan. The business plan is an incredibly important tool for a number of reasons. If the founders cannot state the business case in writing as to why the enterprise is a viable commercial enterprise, they might as well quit before they start. The discipline of writing out a business plan in an organized and compelling form helps an entrepreneur to get focused on the truly important aspects of the enterprise. Further, it should provide a roadmap on where the business intends to go so that an entrepreneur has a clear idea of the trajectory of the enterprise.

Perhaps the worst business plan I ever read was created by a pair of Harvard MBA graduates. It was beautifully printed in color with wonderful diagrams and graphs and was at least 75 pages long. The problem with it was that the underlying business related to high-end gifts for pets and was not at all compelling. The market for high-end gifts for pets is clearly limited! In contrast, one of the best business plans I ever read was 1 1/2 pages long in broken English from an expressive Israeli entrepreneur who even misspelled the word "warehouse" as "whorehouse." But the underlying business concept was so compelling that the company immediately obtained venture funding and eventually went public. So the moral of this story is that to attract venture capital investors, substance counts considerably more than form.

In short, here is what a good business plan should describe:

1. The market
2. The unmet need in the market
3. The solution

Or, to state it another way:

1. Describe the opportunity of the market
2. Describe the problem in the current market
3. Set forth the solution (which is the business!)

The plan should be concise: 20 to 30 pages should be sufficient and should include a brief two-page Executive Summary. You should be able to describe the basic premise of the enterprise in three to five sentences. If you cannot, then you are not thinking clearly and focused enough, and the business is likely to fail.

The business plan must include data to support your contentions about the market and the problem in the market. The plan should also include proprietary aspects such as technology and patents, as well as the business's competitive advantages. Financial projections must be included, and for the first year, should be on a month-to-month basis. Financial projections should focus on at what point in time will the business be cash-flow positive or as I state it — self-sustainable. There is a huge difference in the valuation of a business when it needs capital solely for growth and not to cover its operating deficit. Most importantly, the financial projections must be believable. Outrageous or preposterous projections are a quick invitation to be "dinged" by the venture capitalist.

One of the critical issues for a venture capital firm is whether the opportunity is large enough to make it worth the bet. The venture capital funds are designed to obtain outsized returns on companies that can grow rapidly from a start-up to an enterprise of significant and meaningful value. Venture capitalists are not in the business to grow small businesses. The venture funds assume that many of their investments will not succeed so that the ones that do must succeed in a very large way. Many opportunities presented to venture funds are simply too small and will be dinged.

Another reason that a venture firm may pass on a company is that the business plan is unbalanced. If a venture firm feels that the founders are not being realistic about the business or the industry and neglects to discuss possible negative assumptions, such as potential competition, it raises a red flag to potential investors and diminishes the chance that a venture firm will invest. Sometimes a business plan is just too long and overwrought with too much irrelevant information.

Once the business plan is ready, the next task for the entrepreneur is getting it in front of the right venture capitalist and getting the opportunity to make that all important pitch. The key will be to find the right financial backer that shares your vision and will work with you as a partner as you create a sustainable business.

Authors

Daniel I. DeWolf, Member / Chair, Technology Practice; Co-chair, Venture Capital & Emerging Companies Practice

Daniel I. DeWolf is an authority on growth companies and serves as Chair of Mintz's Technology Practice Group and Co-chair of the firm’s Venture Capital & Emerging Companies Practice. He has worked on pioneering online capital-raising methods. He also teaches venture capital law at NYU Law School.