Briefing Note for CLA members

Business Planning (2)

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In order to assist members during the agricultural transition, the CLA has produced a series of briefing notes on business planning. These provide information on what members need to consider when they are either developing their existing business or are considering a new business venture.

The importance of business planning

Why businesses need a plan

A business plan should never be considered as a “one-size-fits-all” document. Rather, it should be written in a way that is specifically designed for a particular audience. There are various audiences that will need to be targeted and this means that the business plan will need to be altered to meet a specific audience need.

However, this does not actually mean that a number of different business plans will be needed; rather, for one audience a particular piece of information may be required, for another some parts of the plan may need more emphasis and focus than others. Each section of the business plan will need to be justified and the rationale for the statements made in the plan set out clearly.

Who is the business plan trying to persuade?

The main audiences for the business plan are set out below.

<u>The bank manager</u>

Banks, and indeed anyone who is considering either lending capital or seeking to invest in the business, will want some form of asset security to support the loan made. For many landowners who are seeking to diversify, for example, this will often be in the form of using the holding as collateral.

As importantly, the bank will want the near certainty of being able to get the money back. Ambitious growth prospects for a start-up are likely to be counterproductive as, to hit growth targets, it is likely that more capital is required before the business itself becomes profitable.

The bank will also want to charge an interest rate that reflects prevailing market conditions and the potential level of the risk involved. It is important to remember that the bank will usually

expect a business to start repaying both the loan and the interest on a monthly or quarterly basis immediately after the loan has been granted.

The bank will not want the business venture to fail for two main reasons: firstly, it will want to lend the business money in the future; and secondly, it will want to provide more banking services such as insurance and tax advice to a loyal customer.

Investors

It is unlikely that investors will expect a new business to have many assets. They are, therefore, more likely to take risks. However, as the risks in investing in new and young companies are often greater than those associated with established businesses, investors will expect the opportunity for larger returns on the capital invested. For example, fund managers will want to keep failures to a minimum as well as picking big winners to offset potential loss. These "winners" will tend to be companies with annual compound growth rates above 50 percent.

In terms of venture capital fund managers, their objective is a clear return on investment. This means that, if the business is looking to secure investment from the venture capitalist market, the business plan needs to emphasise the prospects of fast growth and significant returns. In addition, the venture capitalist will expect a shareholding in the business in return for the investment made.

However, it is important to stress that certain new businesses (in the main small businesses that see growth in the medium to long term) should not seek investment from venture capitalists as the risks could be too high and the returns from the investment too low.

Summary

If there is a new business venture or an established business, for it to grow it will need a business plan. Preparing a business plan is essential if the business is to effectively focus its strategy and is serious about either entering a market or expanding the business. It is also an opportunity for the business to make any mistake on paper rather than in the actual trading environment.

Once completed, the business plan will need to act as a blueprint to follow which, like a map, improves the user's chances of reaching the destination.

But, despite the obvious benefits, thousands of potential entrepreneurs still attempt to start a business without any form of business plan. The most common of these are businesses that appear to need no or little capital at the beginning or where funds are already provided. In both cases it is believed to be unnecessary to expose the business to harsh financial appraisal by others.

However, such businesses are already at risk for two reasons: firstly, not all customers will pay on time; and secondly, not all suppliers will wait months to be paid. In the meantime, the business must finance the operation. In fact, two market rules still apply: either the product or service on offer fails to sell fast enough and unpaid stock builds up all of which will ultimately have to be financed; or the product or service does sell rapidly in which case other competitors are attracted into the market. Without the staying power that adequate finance provides, these new competitors could rapidly kill off the new business entrepreneur.

Those “would-be” entrepreneurs with funds of their own tend to think that the time spent in preparing a business plan could be more usefully spent doing other things. In short, anything that inhibits them from immediate action is viewed as time-wasting.

As most people’s perception of their business is often flawed in some important respect, it is also the case that beginning a business without carefully setting out the aims, objectives and strategy of the business that the business plan provides is unnecessarily risky. Flaws can often be discovered cheaply and in advance when preparing the business plan; but they are always discovered in the market place, invariably at a much higher and, for some businesses, fatal cost.

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