UNIT 6 PREPARATION OF BUSINESS PLAN AND PROJECT

Structure

6.0 OBJECTIVES

After reading this unit, you will be able to:

- plan the business outline;
- analyze why a business plan is important;
- list the inputs required for preparation of a business plan;
- describe the components of a business plan;
- state the preparatory issues of a business plan;
- prepare a project report; and
- evaluate the project report.

6.1 INTRODUCTION

"New businesses fail usually due to poor management, not because of the idea for the business." — Peter Drucker, internationally renowned management expert

A difficult question for a new entrepreneur is to decide how to begin. The range of options includes selection of a product for trade or industry, form of ownership, selection of site, location, investment, selection of a manufacturing process or service, a feasible business plan, registration of the plan with local authorities or District Industries Centre if required, obtaining power-water connections, pollution control clearance if applicable, registration with sales, income tax departments, approvals of weights and measures/drug controllers/ inspector of explosives and boiler inspectors, etc. An entrepreneur must prioritize these activities with care.

The preparation of a written business plan is not the end result of the planning process. Planning is deciding in advance what to do, how to do, and when to do. It is a blue print for action. The realization of that plan is the ultimate goal. The formal business plan is just as important for an established business, irrespective of its size, as it is for a startup. It serves four critical functions as follows:

- Helps management or an entrepreneur to clarify, focus and research their business's or projects developments and prospects.
- Provides a considered and logical framework within which a business can develop and pursue business strategies over the next three to five years.
- Serves as a basis for discussion with third parties such as shareholders, agencies, banks, investors etc.
- Offers a benchmark against which actual performance can be measured and reviewed.

6.2 BUSINESS PLAN AND ITS PURPOSE

A business plan is essentially a written description of a business's future. It provides an in-depth report on the environment in which the company functions, what the company plans to do in the near future and predictions on its performance. A business plan conveys your business goals, the strategies you'll use to meet them, potential problems that may confront your business and ways to solve them, the organizational structure of your business (including titles and responsibilities), and finally, the amount of capital required to finance your venture and keep it going until it breaks even. A satisfactory business plan must be realistic and attainable so as to allow managers and entrepreneurs to think strategically and act operationally.

Business plan helps to understand the business in a systematic way so that not even a single point is missed out. Following are the purposes of making a business plan:

1) Business plan helps the business owner to concentrate on the objectives and think about the critical requirements of that particular business.
2) Business plan also helps to set guidelines and milestones in a written format.
3) It helps to focus ideas and study chances of the growth of a business.
4) It serves as an operational tool which gives details of the past, present and future activities of a business. In addition, it tells us which function of the business set-up will fulfill which activity to help to its desired goal.
5) Business plan helps to manage a business.
6) It is also used as a communication tool. It provides the information needed to communicate with others. It defines the business proposal, the competition and the management of the business.
7) It can also be used as a financial proposal that can be used by business/ company owners to show it to financers for funding. Business plan helps to make investors understand the reason they should spend money on a company.

There are three primary parts of a business plan:

i) The first is the *business concept*, where you discuss the industry, your business structure, your particular product or service, and how you plan to make your business a success.

ii) The second is the *market place section*, in which you describe and analyze potential customers: who and where they are, what makes them buy and so on. Here, you also describe the competition and how you will position yourself to beat it.

iii) Finally, the *financial section* contains your income and cash flow statement, balance sheet and other financial ratios, such as break-even analysis. This part may require help from your accountant and a good spreadsheet software program. Breaking these three major sections down even further, a business plan consists of six key components:

- Executive Summary
- Business Description
- Marketing Plan
- Production Plan
- Operations and Management Plan
- Financial Analysis

i) **Summary:** The first page of a business plan is summary. Summary should be concise and should cover all the essential details because the first page of a book only encourages a reader to continue reading the book. The summary should include the following points in brief:

- Company's / Business's description
- Company's / Business's objectives
- Company's products/services
- Competitors and market profile
- A statement which defines why and how the business will succeed
- Projected growth for the company
- Key management team
- Funding requirements, time-line for the funds and how the funds will be used.

ii) **Business description** is your Business' / Company's vision and mission. Business description includes:

- Information about your company – who you are?
- What your company is going to offer – what you will offer?
- Which market are you going to enter into?
- Why the business idea you think to implement will be successful?

iii) **Marketing plan:** Market research data should be added to the business plan because investors like to invest money in a business which has a team with thorough knowledge of the market. Market analysis section involves:

- A general description of the market a company (businessman) is willing to enter.
- Changes in the market.
- Different market segments.
- Market segments and customers.
- Customer characteristics and needs.
- Customer buying decisions.

Competitive analysis involves the detailed analysis of competitive strengths and weaknesses of you and your company. This section should explain:

- Industry overview
- Nature of the competition
- Industry changes
- Primary competitors
- Competitive products/services
- Opportunities
- Threats and risks

After doing market and competitive analysis the next step is to define the strategy which you will be using to target the market and distribute your products/services. This section should explain:

- Key competitive capabilities and weaknesses.
- Strategy that will be used by you.
- Implementation of the strategy.

iv) **Production plan:** This section explains the products/services offered by your company or what do your company intend to offer. Provide details about the need of your product in the market. This section should contain:

- Description of product/services.
- Positioning of product/services comparative to other competitors.
- Future products/services, your company willing to offer.

v) **Operations and Management Plan:** Operations involve the things required to implement the business idea. This section should explain:

- Human resources plan.
- Delivery of product/services.
- Customer service.
- Facilities provided by your company,

vi) **Financial analysis:** Financial details should include the following points:

- Balance sheets – which indicates the owner's equity and your financial position.
- Profit and loss statement – alternatively known as income statement, indicates your company's cash management.
- Cash Flow statement – details all cash receipts and disbursements.
- Some key ratios for the projections that are made by you for the next few years.

A business plan should be a realistic view of the expectations and long term objectives for an established business or new venture. It provides the framework within which it must operate and, ultimately succeed or fail. For management or entrepreneurs seeking external support, the plan is the most important sales document that they are ever likely to produce as it could be key to raising finance etc. A clearly written and attractively packaged business plan will make it easier to interest possible supporters, investors etc. A well prepared business plan will demonstrate that the managers or entrepreneurs know the business and that they have thought through its developments in terms of products, management, finances and most importantly markets and competition.

Features of an Ideal Business Plan

Following are the important features of an ideal business plan:

1) It should be written in simple language.
2) It should be informative.
3) It should clearly identify the products, services, markets and promoters of the business.
4) It should be complete and accurate.
5) It should be convincing so that the bankers are able to sanction loans.
6) It should be dynamic in nature.
7) It should have a pragmatic approach.

6.3 INPUTS REQUIRED FOR A BUSINESS PLAN

A business plan, also known as feasibility plan, comprises several elements which should be taken into account. Following inputs go into the making of a business plan:

I) Information about the Industry

II) Information about the Enterprise

III) Information about Product/Service

IV) Information about Market Research

V) Information about Market Plan

VI) Information about Operation Plans

VII) Information about Finance

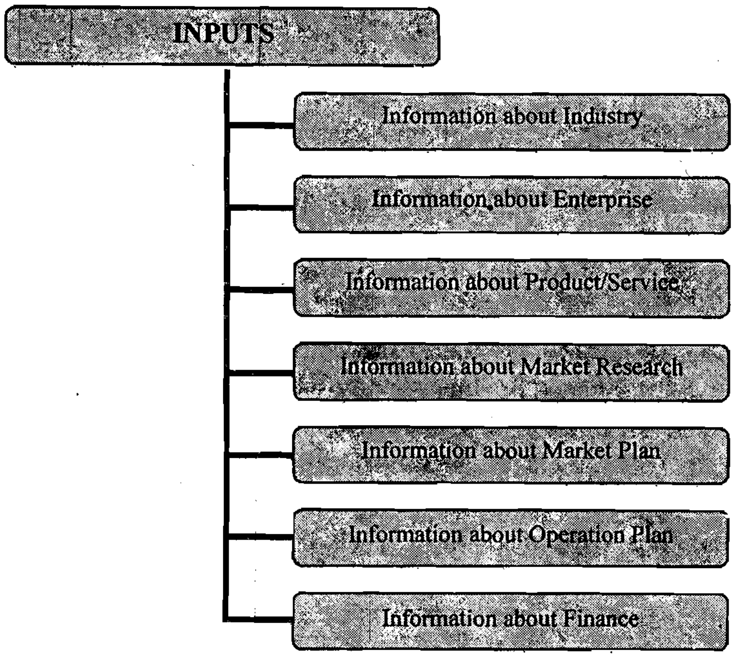

Fig. 6.1: Diagrammatic representation of inputs that go into making of a business plan

Let's, now discuss these inputs one by one.

I) ***Information about the industry:*** A business plan, to start with, should contain an analysis of the industry. It should contain information like type of industry, its past and present performance, allocation of investment of funds, choice of technique etc.

II) ***Information about the enterprise:*** Information about the enterprise includes analysis of past performance, capacity utilization, profitability etc. The purpose of the new venture (like manufacturing, processing, trading, providing services etc.) should be clearly defined. Forms of business organisation (like sole proprietorship, partnership, company, co-operative etc.) should also be mentioned.

A business plan should describe the entrepreneurial team and the role of each person in the new venture.

III) ***Information about product/service:*** Every business plan should explain its product to be sold or service to be offered. Usually, following points are described:

- Name of the product to be manufactured.
- The stage of the business firm has reached to develop the new product e.g. whether such product is at research, design, testing stage, etc.
- The quality of the product.
- Price of the product.
- Method of using the product.
- Material required.
- Cost of the product.
- Method of manufacture (e.g. technology profile).

- Legal protection (e.g. patents, trade mark, copy right etc.).
- Potential of substitute product which may pose competition.
- Licence requirement.
- Diversification plan.

IV) ***Information about market research:*** Under this head, the findings of market research should be provided so that it can be proved that a market really exists for the proposed venture. The entrepreneur must provide a summary of the following important points:

i) *Potential customers:* Information about potential customers helps in explaining the market size and likelihood of generating sales. Following factors are analysed under this head:

- Age of the customer
- Gender of the customer
- Family income
- Occupation
- Location

ii) *Market:* A business plan is a forecast for the present and future market. It includes information about market trend etc.

iii) *Competitors:* A business plan should provide information about the potential competitors. This includes:

- Identification of existing competitors.
- Explanation of their strengths and weaknesses.
- Impact of the new venture on the rivals.

iv) *Pricing system:* Under this head the following information should be analysed:

- Price of the product
- Credit Policies
- Discount system
- Pattern of Allowances

v) *Distribution system:* As regards distribution system, methods of distribution should be analysed. These methods include:

- Direct Sales through showrooms, mail etc.
- Distribution through retail houses.
- Distribution through wholesale establishments.
- Distribution through franchising system.
- Distribution through telemarketing.
- Distribution through door-to-door selling.

V) ***Information about market plan:*** A market plan can be made after proper market research. It describes the intended strategy of a businessman. Following inputs should be provided:

- Product – quality, use etc., of the product.
- Pricing System – pricing method, discounts, allowances, taxes and duties, quantity, etc.
- Promotion – branding, advertising, demonstration, gifts, coupons, etc.
- Distribution – use of market channels or other approaches.
- Services – after sales service, installation and repair services, guarantee and warranty of a product, etc.
- Names and designations of the persons responsible for marketing and sales.

VI) ***Information about operation plans:*** Under this head the following important aspects shall be covered:

- Choosing a location
- Purchasing property
- Parking and transportation services
- Dealing with legal issues
- Renovations
- Equipment and technologies
- Inventory management
- Human resources
- Quality control
- Insurance
- Patents
- Copy-rights

VII) ***Information about finance:*** Money is one of the important measures used to gauge the progress of a firm. Hence, a business plan should include projections of financial statements which are based on operating and marketing assumptions. A projected cash flow statement will show the movements of cash in and out of the firm and its net impact on the cash balance with the firm.

Check Your Progress 1

1) Why a business plan is needed?

....

....

....

....

....

....

....

2) What are the inputs required for preparing a business plan?

....

....

....

....

....

....

3) List the key components of a business plan.

....

....

....

....

....

....

6.4 PREPARE A WORK PLAN

Once the plan's structure has been defined, it can be used as a checklist and basis for a work program and timetable to complete the plan. This work program will often require extensive research and thought prior to the commencement of writing. For example, formal market research may be needed before sales volumes and prices can be determined. The work program could correspond to key sections of the proposed plan and could include timetables, resource allocations and cost estimates. Some additional tips and suggestions in this context are as follows:

- Be absolutely clear about the primary purpose and audience of the plan from the outset. If the plan has to serve multiple purposes, consider producing tailored versions (or tailored summaries).
- Allow enough time to produce revised drafts of the plan - three/ four drafts would not be unusual.
- Write the Introduction, Summary and Conclusion of the plan after the plan's main parts have been finalized.
- At an early stage, make some high-level sales and financial projections (covering 1-3 years) to explore the general direction and size of the business, likely viability and possible funding amounts and mix.
- Seek external assistance sooner rather than later. This may take the form of software tools, consultancy assistance in the form of specific assignments, or mentoring and counselling on an as required basis.
- If planning a significant business, ensure that a management team has been identified (and possibly in place) before the plan is finalized.

- Start compiling the plan at the sections devoted to market research/analysis and sales forecasts/plans, or with details of the proposed product/service offerings. Leave the detailed financial projections aside until all details in relation to sales, costs, expenses, operations, capital investment and possible sources/types of finance have been resolved.

6.5 BUSINESS PLAN OUTLINE

One should start by defining an outline (i.e. a table of contents) of a business plan. This will allow one to concentrate on the essentials of planning the business rather than becoming too absorbed in the detailed drafting of plan.

Having created a basic structure for your business plan, the next task is to expand this structure to include subheadings and appendix titles. This extended structure should be critically reviewed to ensure that all the salient elements of the plan are included and that it has a logical flow. This approach should also ensure that the plan has appropriate levels of detail and is correctly targeted at its audience - investors, directors/shareholders, financial institutions etc. For example, a structure which is mainly devoted to detailed technical descriptions of products would be completely unsuited to a plan being used to raise bank credit.

Use the below mentioned as the road map for your plan and then write up each section concisely but comprehensively.

i) **Introduction:** Introduce the plan and explain that who, when and for what purpose wrote it.

ii) **Mission, Strategies etc.:** What are the central purposes and activities of the planned business?

iii) **Present status:** Summarize achievements and performance to date.

iv) **Product/service offerings:** Keep descriptions short and confine them to broad groups. Explain briefly what makes them special.

v) **Profiles of target markets:** Size, segments, trends, competition and user/customers profiles.

vi) **Marketing strategies, sales plan, and projections:** How will the businessmen, market its products/service and sell these products to customers?

vii) **Technology and Research & Development:** If relevant, explain progress, plans, and resources and highlight any technological advances.

viii) **Operational/manufacturing plans:** Cover distribution and service activities and/or manufacturing.

ix) **Management and administration:** Introduce the proposed management team, structure etc., indicating administrative arrangements and specify overhead costs.

x) **Financial projections:** Use simple table to present key financial projections.

xi) **Funding requirements and proposals:** If applicable, summarize funding requirements, possible sources, likely terms, and for investors, the projected returns on their investment.

xii) **Implementation:** Explain the major decision points, time scale and actions required by management and others to progress the plan.

xiii) **Conclusion:** Indicate why and how the business will succeed and why it should be supported?

xiv) **Summary:** Presents the highlights of the plan. It should be written in last, but all the points must be covered in it.

xv) **Appendices:** Use appendices at the very back of the plan to present important background data and detailed plans.

6.6 PREPARATION OF PROJECT REPORT

A project report is a formal version of a business plan. It gives a complete analysis of inputs and outputs of the project. It enables the entrepreneur to understand at the initial stage whether the project is sound on technical, commercial, financial and economic parameters. On the basis of project reports an entrepreneur takes his decision on whether to proceed on the proposed project or not. The financial institution will also base their decision to extend finance and other support on the basis of the project report. A project report also helps in convincing the investors operating in the money market to invest funds in the business.

It is necessary to prepare a project report according to the format of the loan application of the concerned term lending institutions. The project report can be made either by the entrepreneur himself or by a consultant.

Aspects covered under a Project Report

A project report provides a bird's eye view of all the activities of a business firm. The various aspects of the information have to be systematically estimated and presented mentioning the various opportunities and constraints.

A project report includes information on the following aspects:

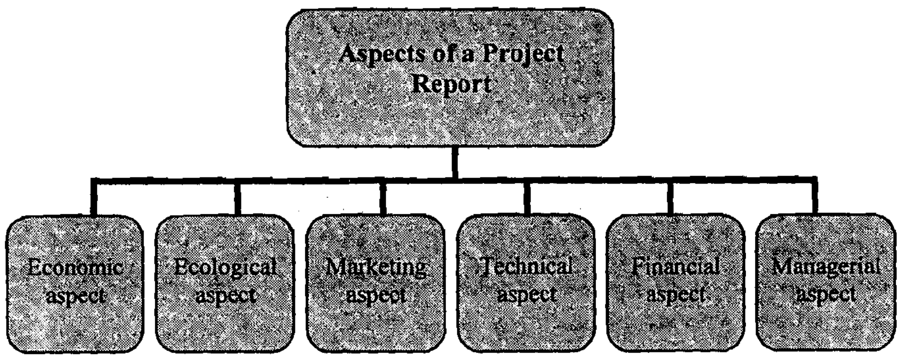

Fig. 6.2: Diagrammatic representation of various aspects of a project report

Let's now discuss these points one by one:

i) *Economic aspect:* It is also referred to as social cost benefit analysis. It is concerned with judging a project from the larger social point of view. The impact of the project on the distribution of income, level of savings and investments in the society are analyzed.

ii) *Ecological aspect:* Ecological analysis is to be done for major projects which have ecological implications like power plants and irrigation schemes and environmental polluting industries. The likely damage caused by the project to the environment is to be seen.

iii) *Marketing aspect:* The project report should indicate demand for the product and the market share the project under appraisal can obtain. Information regarding consumption trends, structure of competition, elasticity of demand, distribution system, marketing policies, legal constraints, cost, preferences and requirements of consumers, etc., should also be mentioned.

iv) *Technical aspect:* The appropriate report should give details about the techniques and technologies needed, equipments, raw material, machinery, power and other inputs required and the sources of their availability. Information regarding location and site, size, plant capacity, etc., needs to be mentioned.

v) *Financial aspect:* The report should indicate the amount of capital required. The amount to be contributed by the proprietor should be mentioned and the various other sources of finance should be indicated. Expected rate of return should be specified. Cost of project, projected profitability, break-even point, cost of capital, level of risk, projected financial position should be clearly indicated.

vi) *Managerial aspect:* The report should contain qualification and experience of the entrepreneurs and key personnel i.e. the persons who will be managing the show.

6.7 PROJECT EVALUATION

Now, we know that the entrepreneur has to submit a project report to his bankers in order to avail loan facility from them. Project evaluation is the assessment of a project by a bank/term-lending institution. It is a complete and critical scanning of the project. It is the analysis of cost and benefit of the proposed project. The bank/term-lending institutions after receiving the loan application along with project report critically scrutinize it. They intend to ascertain the possibility of generation of funds by the project itself and whether or not it would be substantial enough to repay the amount advanced within the fixed time.

The method of analysis of a project report usually varies from project to project i.e. method of analyzing a project by Canara Bank may be different with that of Delhi Financial Corporation. The various aspects that are taken into account by the evaluator are examined below:

i) Economic viability
ii) Ecological viability
iii) Technical viability
iv) Marketing viability
v) Managerial viability
vi) Financial viability

Financial aspect of project appraisal covers the following areas:

- Cost of project
- Sources of finance

- Projected income statement
- Projected balance sheet
- Break-even analysis
- Projected cash flow statement
- Pay back period
- Internal rate of return

6.8 COMMON ERRORS IN FORMULATION OF BUSINESS PLAN AND REMEDIES

Following Table indicates the various common errors which may be committed while formulating a business plan. The Table also contains remedies which will help in avoiding such errors:

Table 6.1: Common errors in business plan and Remedies

	Common Errors	**Remedies**
i)	The entrepreneur may make heavy investment in land and building in the initial stages which may result in un-economic working due to heavy interest burden on un-productive assets if these are under-utilized.	At the initial stages heavy investment in un-productive assets should be avoided. Such investment may be diverted for purchasing imported machinery and good quality raw material.
ii)	Plant and machinery purchased is unbalanced i.e. the capacity at various stages of production is not matched to give the desired output which may result in low production.	A critical analysis of the various technical factors can help the entrepreneur to prevent the unit from getting into difficulties at a later stage.
iii)	The management is ineffective in controlling functions like production, marketing, finance etc.	Experienced personnel should be recruited. Their roles should be clearly defined with proper delegation of authority.
iv)	The business is more at risk if decision making in all areas is in the hands of one man i.e. one man show.	The businessman should keep important decisions in his hands. Routine business activities should be delegated. Principle of *'management by exception'* should be followed.
v)	Promoters are weak in respect to experience, qualification etc.	Experts may be roped in either as partners or employees or consultants.
vi)	The project report may not show enough profits to service its debts and for future development.	Avoidable and unnecessary expenditure may be reduced.
vii)	A project report when written by the businessman himself may contain mistakes.	The project report may be prepared with the help of experts.
viii)	Projections given in the project report are only for short period.	The project report should contain projections for at least five years.
ix)	Wrong and unrealistic estimations are incorporated in the project report.	Wrong and unrealistic estimations should be avoided. The estimations should be based on authentic information.
x)	Wrong estimate of fixed capital are incorporated in the business plan leading to long term adverse effects on the financial position of the enterprise and also on its profitability. It may lead to over/under capitalisation.	With careful planning the businessman should correctly estimate the fixed capital so that there is no under or over capitalisation in the long run.

Check Your Progress 2

1) Answer in True/ False

   i) Well written business plan is a blue print for action. (................)

   ii) It is very essential to identify and address all the key issues before writing a business plan. (................)

   iii) A plan should have appropriate levels of details for the targeted financial institution. (................)

   iv) Generally introduction, summary and conclusion of the plan are written after main parts have been finalized. (................)

2) Fill in the blanks:

   i) .... plan and .... plan are two key components of a business plan.

   ii) The business plan should start with an overall ....of the business.

   iii) A project report can be prepared on the basis of ....

   iv) A project report is generally evaluated by ....

3) Mention the points which will be examined by the bank at the time of project evaluation.

   ....

   ....

   ....

   ....

   ....

4) Mention any two common errors which a project report may contain.

   ....

   ....

   ....

   ....

   ....

   ....

6.9 LET US SUM UP

An entrepreneur should prepare a written business plan. It will provide a considered and logical framework within which business will take shape in the coming years. The primary parts of a business plan are business concept, market place section and financial section. Business goals should be quantifiable, consistent, realistic and achievable. It will be better to use simple table to present key financial projections. The highlights of the plan should be written at the end but it should cover all the main points. The appendices at the very back of the plan should present important background data and detailed projections.

6.10 KEY WORDS

Inventory	:	Inventory is a list for goods and materials, or those goods and materials themselves, held available in stock by a business.
Patents	:	A patent is a set of exclusive rights granted by a state to an inventor or his assignee for a fixed period of time in exchange for a disclosure of an invention.
Break-even Point	:	A break-even point of a business enterprise is the level of output or sales at which the business enterprise just breaks-even i.e. there is neither a profit nor a loss.
Cash Flow Statement	:	A projected cash flow statement is a summary of all the sources of cash available (cash inflows) during the course of operation within a period of time and its possible uses (cash outflows) during that period.
Pay Back Period	:	This period refers to the length of time which is required to recover the initial cash investment made in a project. A project with a shorter pay back period is always preferred.
Internal Rate of Return	:	It means the discount rate which equals the present value of investment in the project to the present value of future returns earned during the life time of the project. It indicates earning capacity and a higher value indicates better prospects for the project.

6.11 SOME USEFUL BOOKS/REFERENCES

Bidani, Mitra and Promod Kumar (1996) *Bank Finance for Industry*; Vision Books, New Delhi, Edition.

Chandra, Prasanna (1996) *Projects, Planning, Analysis, Selection, Implementation and Review*; Tata McGraw-Hill Publishing Company Limited, New Delhi, Fifth Reprint.

Desai, Vasant (1996) *Dynamics of Entrepreneurial Development of Management*; Himalaya Publishing House, Mumbai, Reprint.

Jerry Jinnett Pinson (1999). *Anatomy of a Business Plan*, Dearborn Trade.

Joseph A. Covello, (1994). *The Complete Book of Business Plans: Simple Steps to Writing a Powerful Business Plan.*

Mike P. McKeever (2005). *How to write a Business Plan.*

Nabhi Publication (2004) *How to Borrow from a Baking and Financial Institution*; Nabhi Publications, New Delhi, Edition.

6.13 ANSWERS TO CHECK YOUR PROGRESS

Check Your Progress 1

1) A business plan is needed because of following reasons:
   - Business plan helps the business owner to concentrate on the objectives and critical requirements of that particular business.
   - It also helps to set guidelines in a written format.
   - It helps to focus ideas and study chances of the growth of a business.
   - It serves as an operational tool which gives details of the past, present and future activities of a business.
   - It helps to manage a business.
   - It is also used as a communication tool.
   - It can also be used as a financial proposal to financers for funding.
2) Following inputs are required for preparation of a business plan:
   - Information about the Industry.
   - Information about the Enterprise.
   - Information about Product/Service.
   - Information about Market Research.
   - Information about Market Plan.
   - Information about Operation Plans.
   - Information about Finance.
3) Key Components of a business plan are as follows:
   - Executive Summary
   - Business Description
   - Marketing Plan
   - Production Plan
   - Operations and Management Plan
   - Financial Analysis

Check Your Progress 2

1) Ture/ False

   i) True ii) True iii) True iv) True
2) Fill in the blanks

   i) Production, marketing

   iii) Background, structure

   iii) Business plan

   iv) Banker

3) Following points are examined by the bank at the time of project evaluation:

   - Economic viability
   - Ecological viability
   - Technical viability
   - Marketing viability
   - Managerial viability
   - Financial viability

4) Two common errors which a project report may contain are as follows:

   i) The entrepreneur may make heavy investment in unproductive assets (like land and building) in the initial stages.

   ii) The project report may not show enough profits to service its debts and for future development.