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1. THE ROUTE FROM CONCEPT TO COMPANY

New, innovative companies generally try to grow from start-ups into established companies within 5 years. But they can seldom finance their activities alone along the way. Rather, they are dependent on professional investors with considerable financial clout. For entrepreneurs, financing is a critical question – the business plan must thus be considered from the point of view of potential investors right from the outset.

1.1. Success factors

Successful companies arise from a combination of five elements (Exhibit 2).

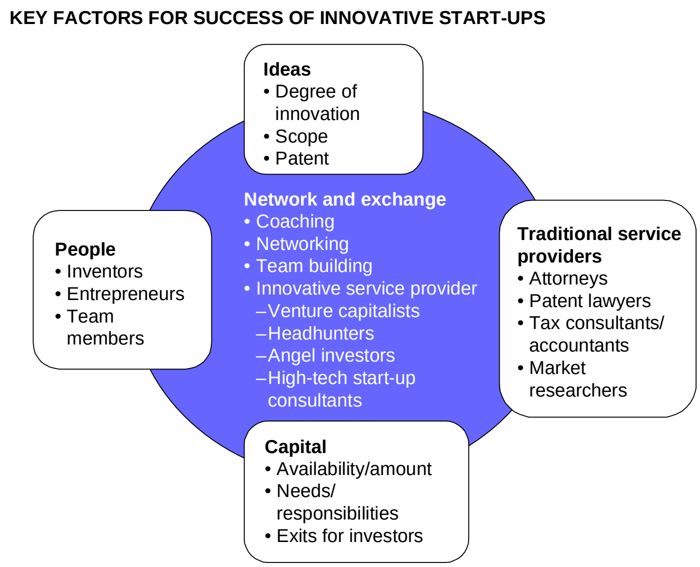

Exhibit 2

1. No business concept, no business

Having an idea is just the beginning of the creative process. Many entrepreneurs are initially infatuated with their inspiration, losing sight of the fact that their idea is the point of departure for a long process of development which must face – and withstand – tough challenges before it can enjoy financing and market success as a mature business concept.

2. Money matters

Without somebody who invests money into the idea to grow it into a viable business, this business will never become a reality. From early on, therefore, much attention must be paid to convincing investors to provide the necessary funding.

3. No entrepreneurs, no enterprise

Growing new firms is not a one-person job. It can only succeed with a team of, usually, three to five entrepreneurs whose talents are complementary. Putting together well-functioning teams is a difficult process – one that takes time, energy, and an understanding of human nature. Do not lose any time in putting your team together and work on perfecting it throughout the entire start-up process. The characteristics of a high-performance management team are discussed in more detail in section 6.3 of this Guide.

4. Traditional service providers will help you clear the first hurdles

You will often need the advice of professional service providers, such as patent lawyers, tax advisors, and market researchers - especially at the beginning. Getting the right information early (e.g., for registering a patent) can have consequences for later success or failure.

5. Strong networks are a "shot in the arm" for every new company

Professional guidance for potential entrepreneurs through a network of sponsors, entrepreneurs, venture capitalists, and service providers is decisive in transforming viable ideas into real companies. Prime examples for such regional networks can be found in Silicon Valley and the Boston area.

1.2. Stages of development

The typical progression of the start-up and development of growing companies into established firms can be subdivided into three stages. The end of each stage serves as a milestone for venture capitalists by which to gauge the status of their investment. Being familiar with each stage and the challenges it poses may spare you wasted energy and disappointment. Please note, however, that the three stages in the development of a functioning start-up do not match the three phases in the development of a business plan within the framework of this competition (see Exhibit 3).

If you intend to be successful, this start-up process should influence both your activities as the initiator of a business concept and your path toward forming your own company. To a large extent, it is the demands of investors that will determine how you must approach the individual stages of the start-up.

STAGES OF START-UP DEVELOPMENT

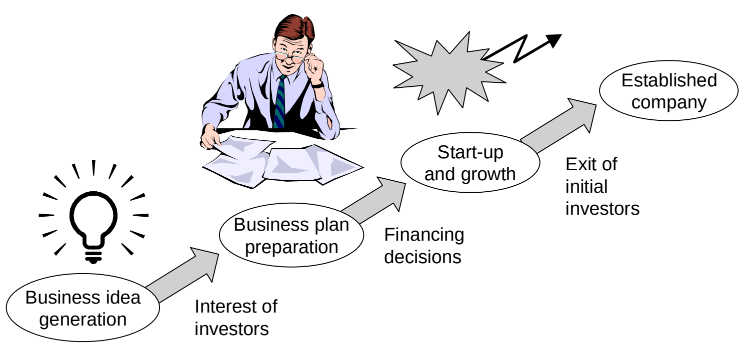

Exhibit 3

Stage 1: Business idea generation

The beginning is the inspiration – your solution to a problem. It must be evaluated to determine if it delivers an actual customer value, whether the market is big enough, and just how big it will be. The idea itself has no intrinsic economic value. It acquires economic value only after it has been successfully transformed into a concept with a plan and implemented.

You will need to start putting together your team as soon as possible, finding partners who can develop your product or service until it is ready for market (or at least until shortly before). In the case of products, this stage usually involves a functioning prototype. You will most likely have to do without venture capital during this stage. You will still be financing your plan with your own money, help from friends, perhaps state research subsidies, contributions from foundations, or other grants. Investors refer to this as "seed money," as your idea is still a seedling, not yet exposed to the harsh climate of competition.

Your objective at this stage is to present your business concept and market – which forms the foundation of your new company – so clearly and concisely as to pique the interest of potential investors in helping you cultivate your idea further.

Stage 2: Business plan preparation

At this stage, it is most important to focus on the big picture: Don't lose sight of the forest for the trees! The business plan itself will help you to focus as you must consider and weigh the risks involved, prepare for any contingency, and learn to anticipate a variety of possible situations or "scenarios." You will need to lay down plans and create a budget for the key activities of the business – for development, production, marketing, distribution, and finance. Naturally, you will need to make many decisions, such as which customers or segments will you target? What price will you ask for your product or service? What is the best location for your business? Will you handle production yourself or outsource it to third parties? And so on.

In preparing the business plan, you will come in contact with many people outside your start-up team. In addition to investors, you will talk to many specialists, including attorneys, tax advisors, experienced entrepreneurs, and experts. The business plan competition organizers will help you get in touch with just the right people. You will also have to begin reaching out to your potential customers (i.e., by means of consumer surveys) to make initial assessments of your market. Always keep in mind that customer acceptance is an essential prerequisite to the success of your company! Scout about for possible suppliers and perhaps close your first agreements. You will also want to become aware of who your competitors are.

This whole process will not come cheap. The team must continue to earn a living while running a rudimentary operation and perfecting a prototype. Yet at this stage, you should also be able to estimate your expenses. Financing will generally still be provided from the same sources you relied on during stage one, although some investors may be willing to make the occasional advance. This stage concludes successfully for you as a new entrepreneur when an investor expresses a willingness to finance your undertaking.

Stage 3: Start-up and growth

Now that the conceptual work is largely complete, it is time to start implementing your business plan. Your role now changes from that of architect to that of builder. Business success must now be sought and achieved in the market. The day of reckoning has come when you will learn whether your business concept was a good and, ultimately, profitable one.

Investor exit en route to becoming an established company

The pullout of your initial investors is a completely normal step in the development of a start-up. For if everything has gone well, your risky venture will have gradually become a stable enterprise (see Exhibit 4). In the course of its short life, you have created a number of jobs and wooed many customers with your innovative solution to their problem. Your commitment is paying off as the value of your business increases.

A profitable exit has been the objective for the venture capitalist from the outset. Capital recovery can happen in very different ways. Normally, the business is sold to a competitor, supplier, or customer. Or it is listed on the stock exchange (the "initial public offering" or IPO). It is also possible for investors who want out to be paid off by the other partners.

2. THE BUSINESS IDEA

"There is nothing in the world as powerful as an idea whose time has come."
Victor Hugo

The above statement undoubtedly applies to ideas for starting a new business. But how do you come up with such an idea? And how can you know if the idea for the business will have a promising future?

Studies show that the lion's share of original and successful business ideas were generated by people who had already had several years of relevant experience. Gordon Moore and Robert Noyce, for example, had a number of years at Fairchild Semiconductors behind them before teaming up with Andy Grove to form Intel. But there are also examples of revolutionary ideas brought to life by mere novices as Steve Jobs and Steve Wozniak demonstrated when they dropped out of college to start Apple Computer.

2.1. Developing a business idea

In economic terms, a spark of genius is worthless, no matter how brilliant it may be. For an idea to grow into a mature business concept, it must be developed and refined, usually by many different people.

The initial idea must first pass a quick plausibility check
Before you follow up on an idea, you should evaluate it in light of its (1) customer value, (2) market chances, and (3) degree of innovation, as well as considering whether it will be both (4) feasible and profitable.

- Talk your idea over with friends, professors, experts, and potential customers. The broader the support you find for your idea, the better you will be able to describe its benefits and market opportunities. You will then be well prepared when the time comes to discuss your project with professional investors.

- Is your idea really novel? Has someone else already developed it or even applied to patent it?

- Will it be possible to develop your idea in a reasonable period of time and with a justifiable level of resources?

It takes at least four weeks to develop a business idea
Considering the multiple stages of development, it is improbable – and fairly unrealistic – that you will spend fewer than four weeks developing your concept. Generally, a business idea is not worthy of being financed until it is so concrete that it can be launched in the market in the foreseeable future at reasonable risk. Investors talk of the "seed phase" of a business concept,

which usually has to be financed with "soft" money (i.e., from sources that as yet place no hard and fast demands on the success of the idea).

The seed phase can take longer, in particular if the idea is ahead of its time. Although the perfect product has been found, it cannot yet be marketed because the development of complementary technologies or systems is still in the works. One example is the Internet. The ideas for marketing products and services came early, but a lack of security in the available payment systems hampered and delayed its commercial exploitation for some time.

2.2. Elements of a promising business idea

A business idea can be considered promising if it has the following four elements (Exhibit 5):

ELEMENTS OF A PROMISING BUSINESS IDEA

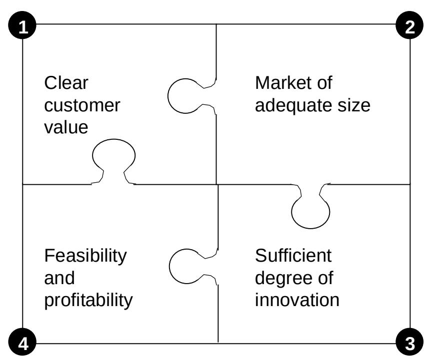

Exhibit 5

1. Clear customer value

The key to success in the marketplace is satisfied customers, not great products. Customers spend their hard-earned money to meet a need or solve a problem. The first principle for developing a successful business idea is that it clearly shows which need it will fulfill and how it will do so. Initially, many entrepreneurs have the product and the technical details of design and manufacture in mind when they speak of their solution. Not so for the investor – the investor first looks at the idea from the perspective of the market. For investors, customer value takes top priority, and everything else is secondary. What's the difference? If innovators say, "our new device can perform 200 operations per minute," or "our new device has 25% fewer parts," they are focusing on the product. By contrast, saying, "our new device will save the customer a quarter of the time and, therefore, 20% of the costs," or "our new solution can boost productivity by up to 25%," adopts the customer's point of view. The product is merely a means of delivering value to customers.

The customer value of a product or service expresses what is novel or better about the item when compared to competitive offers or alternative solutions. As such, it plays a key role in setting your product apart from others – a core issue in marketing, as we will learn – and is essential to the market success of your business concept. Try, whenever possible, to also express the customer value in figures.

Marketing theory states that the customer value must be formulated into a unique selling proposition, or USP. This means two things: First of all, your business concept must be presented in a way that makes sense (selling proposition) to the customer. Many start-ups fail because the customer does not understand the advantage of using the product or service and, as a result, does not buy it. Secondly, your product must be unique. Customers shouldn't choose just any solution that hits the market – they should choose yours. You must, therefore, persuade them that your product offers a greater benefit or added value.

Only then will your customers give you an edge. In describing your business concept, you need not present a fully formulated USP, but it should be more or less obvious to potential investors.

2. Market of adequate size

A business idea will have economic value only when it succeeds in the market. This second principle of a successful idea demonstrates how big the market is for the product offered, which target group(s) it is designed for, and to what degree it will differ from the competition.

A detailed analysis of the market is not yet necessary at this point. Estimates, derived from verifiable basic data, will suffice. Sources could include official statistics, information from associations, articles in trade journals, the trade press, and the Internet. It should be possible to draw a reasonable conclusion about the size of the target market from this basic data. It is sufficient for you to summarize the results of this investigation in your presentation of the business idea.

The same is true for your target customers; you will only need a loose definition of who they will be. Describe why your business idea will provide a special value to this group in particular, and why this group is financially the most interesting to you.

You will always face competition – both direct, from companies that offer a similar product, and indirect, from substitute products that can also fulfill the customer's need. A pasta manufacturer competes not only with other pasta manufacturers, but also with manufacturers of rice and potato products and bakeries and, more generally, with manufacturers of all other food stuffs. Your business idea will need to demonstrate that you have understood who your competitors are. Name them – and describe why and how you can take the lead with your business idea.

3. Sufficient degree of innovation

Business ideas can be classified along two dimensions - products / services and business systems. In each of these categories, you can develop something new or capitalize on something that already exists. Simplified, a business system is a way of understanding how a product or service is developed, manufactured, and marketed (Exhibit 6).

The term innovation is generally used in the context of new products, which are made with conventional production methods and delivered to the customer through existing distribution channels. Microsoft, for instance, developed DOS, making use of the IBM sales organization to bring it to the market.

Innovations in business systems are less obvious, but just as important. The success of Dell is attributed to significant cost savings thanks to a new form of direct distribution and a novel production process in which a computer is produced only after it is ordered, and in the shortest possible time frame.

In developing new products, improvement of the multi-layered dimension "customer value" is at the forefront. Innovations in the business system are targeted at lower costs and faster processes, savings which can then be passed on to the customer in the form of lower prices.

It is rare that both types of innovation – in product and business system – can be combined to create a completely new industry. Netscape contributed significantly to the success of the World Wide Web by distributing its new browser over the Internet free of charge. In doing so, Netscape passed up initial sales revenues but, through the increased number of visitors to its Web site, succeeded in raising advertising revenues.

4. Feasibility and profitability

Finally, to arrive at an actual start-up, the feasibility of the business idea must be assessed. In addition to specific factors that could make the project not feasible (e.g., legal considerations, standards), the assessment may include the time and resources needed to carry out the project. The construction of hotels on the moon may be technically feasible, for example, but their cost-benefit ratio is unreasonable.

Interwoven with the feasibility criterion is profitability. A company must be able to generate long-term profit. This fourth element of a successful business idea should thus indicate how much money can be made and how.

Traditionally, profit calculations for a business are made as follows: A company buys material or services, thereby incurring costs. It also sells products or services to customers, thereby earning revenues. If your business follows this pattern, it is not necessary to provide any greater detail in the description of your idea. Do, however, make rough estimates of anticipated expenses and profits. One rule of thumb for growing companies is that the start-up phase should generate gross profits (revenues minus direct product costs) of 40% to 50%.

But many businesses do not function according to this traditional model. McDonald's, for example, earns its money from the licensing fees it charges franchisers. The restaurant owner pays McDonald's for the name and the way the restaurant is run. If your business idea is based on this kind of innovation in profit generation, you should detail it in your business idea.

KEY QUESTIONS: Business idea

- Who will buy your product?
- Why should customers buy the product? What need does it fulfill?
- How will the product be distributed to the customer?
- What, exactly, is innovative about your business concept?
- How is the business concept unique? Is it protected by patent?
- How is the product better than comparable alternatives?
- What competitive advantages will the new company have, and why can't a competitor simply copy them?
- Can money be made with the product? What costs will be incurred, what price will be asked?

2.3. Protecting your business idea

Only a few ideas are genuinely ingenious. True breakthroughs are the result of hard work and, therefore, cannot be easily replicated. A compromise must be found to protect the idea, while disclosing sufficient information to test its viability.

Patenting

Early patenting is recommended, especially in the case of new products or processes. Get the advice of experienced patent lawyers: The future success of your business can depend on a patent, and, in every industry, there are powerful competitors with the means to keep an unfavorable patent from being granted. But some degree of caution is advised as a patent can also miss the mark when it comes to protecting your idea by making the idea public. Be sure to keep in mind if the patent can be improved upon easily – and thus thwarted. The recipe for Coca-Cola, for example, is still "secret" and has never been patented because the patent can be circumvented with a very few, neutral-tasting changes.

Confidentiality agreement

Lawyers, trustees, and bank employees are all required by law to maintain confidentiality vis-à-vis their clients' businesses. Venture capitalists also have an interest in keeping things under wraps, as someone with a reputation for "poaching" ideas will not be made privy to new ideas any time again soon. The same is true for professional consultants. A confidentiality agreement can be effective in some cases. The coaches and organizers involved in EnterPrize are required to sign a confidentiality agreement; judges are encouraged to do so. But, like every legal document, it has its limits, and there are gray areas that could make it difficult to prove a violation of the agreement in court.

Quick implementation

Your best protection against intellectual property theft is probably to implement your plan as quickly as possible. A great deal of work must be done between dreaming up an idea and opening for business. This effort can keep potential copycats at bay, because in the end, it's crossing the finish line first that makes you the winner, not having the fastest shoes!

2.4. Presenting your idea to investors

How you present your business idea to an investor will put all your previous efforts to the test. It is critical to attract attention and pique interest through content and professional appearance. Good venture capitalists are presented with up to 40 business ideas per week, and their time is limited. In submitting the business idea, neither fanfare nor a wealth of details is as important as a clear and thoughtful presentation.

Example 1: The hard sell

"I have a great idea for a new, customer-friendly method of payment with a big future. This is something everybody has always wanted. You could earn a lot of money from this …" The investor thinks, "That sounds like a lot of hot air. I've heard of a hundred such miracle solutions before … Next!"

Example 2: The technical approach

"I have an idea for a computerized machinery control system. The key is the fully-integrated SSP chip with 12 GByte RAM and the asymmetrical XXP-based direct control unit. It took me 5 years to develop this.” The investor thinks, "Techie. In love with technology. She's her own market … Next!"

Example 3: The entrepreneur

"I have an idea that will enable companies with up to 100 employees to save 3% to 5% of their costs. Initial cost-price analyses have convinced me that a spread of 40% to 60% should be possible. I have found a focused advertising channel through the Association of Small and Medium-sized Businesses and the ABC Magazine. The product will be distributed by direct sale." The investor thinks, "Aha! She has identified the customer value, and even worked out the figures! She's thought about the market and the profit potential and knows how she will get the product to her customers. Now I'd like to get a look at the product…"

These examples demonstrate why clarity should be your foremost goal. It is best to assume that investors are not familiar with the technology of your product or the industry jargon. They are also not likely to take the time to look up an unknown term or idea. Describing your concept clearly and incisively is your next goal. You must be able to convey the basic mechanics of your business idea to an investor with credibility. There will be plenty of time at a later point for detailed descriptions and exhaustive financial calculations.

Formal requirements of a business concept presentation

Title page
Name of the product or service
Name of the person(s) submitting
Confidentiality notice
Illustration, where appropriate, of the product or service in action

Body
4 to 7 pages (including a one-page executive summary)
Clear structure with headings and indentations as visual organizers

Charts, illustrations, tables
Maximum of 4 illustrations, placed in the appendix
Use only if necessary for comprehension
Make reference to the illustrations in the text
Simple, clear presentation
Uniform format

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3. THE BUSINESS PLAN

"Writing a business plan forces you into disciplined thinking, if you do an intellectually honest job. An idea may sound great, but when you put down all the details and numbers, it may fall apart."
Eugene Kleiner, Venture Capitalist

The modest term "business plan" does not really do justice to this very important business tool. The business plan was first used in the U.S. as means of acquiring funds from private investors and venture capitalists who then participate in the company as co-owners and provide the capital. The presentation of this type of start-up strategy has become a mandatory courtesy when seeking to do business with any partners, including customers, suppliers, and distributors, to say nothing of venture capitalists and banks. But business plans are not only used by start-ups; even major corporations rely increasingly on project-specific business plans to help them make internal investment decisions.

3.1. Advantages of a business plan

The great importance attached to the business plan is well justified. With it, entrepreneurs can prove that they are in a position to articulate and handle the diverse aspects of start-ups and their management. Properly conceived and executed, the business plan becomes a key document for evaluating and managing an operation.

A business plan details the overall entrepreneurial concept behind a planned business. It gives an exact summary of the economic circumstances, the targets set, and the resources necessary. The business plan forces entrepreneurs to think through their ideas systematically: It identifies gaps in knowledge, demands decisions, and promotes the formulation of a well-structured and focused strategy. During its preparation, one after the other, alternative approaches come to light and are evaluated, and pitfalls are identified. With its clear analysis of the situation, the business plan becomes an invaluable tool for overcoming problems and contributes substantially to boosting efficiency and effectiveness.

3.2. Characteristics of a successful business plan

How a business plan is designed depends on what kind of venture is envisioned and what the plan should accomplish. If a plan is being written for a start-up, for example, it will necessarily have a different structure than one that aims to launch an existing company into a new segment.

Despite such differences, business plans have a number of things in common. They are to provide a clear and comprehensive evaluation of the opportunities and risks posed by the operation. This is no small task, and completing it will require careful attention to certain standards of design and content.

The following suggestions and guidelines should help you make your plan successful.

A good business plan impresses with its clarity

Readers should be able to find suitable answers to their questions. It should be easy for readers to find the topics in which they are particularly interested. This means the business plan must have a clear structure to enable readers to maneuver and choose what they would like to read.

It is not the volume of analysis and data, but rather the organization of the statements and a concentration on the essential arguments that will persuade your readers. Any topic that could be of interest to the reader should, therefore, be discussed fully, but concisely. A total length of about 30 pages, give or take 5or so, is generally appropriate.

A business plan is not read in the presence of the author, who could answer questions and provide explanations. For this reason, the text must be unambiguous and speak for itself. Each plan should be presented to a test audience, if at all possible, before it is finally submitted. Competition coaches, for example, can help weed out confusing passages or indicate areas still in need of editing.

A good business plan convinces with its objectivity

Some people get carried away when they are describing what they feel is a good idea. While there is something to be said for enthusiasm, you should try to keep your tone objective and give the reader a chance to carefully weigh your arguments. A plan written like glowing advertising copy is more likely to irritate than appeal to your readers, making them suspicious, skeptical, or otherwise unreceptive.

Equally dangerous is being too critical of your own project in response to various past miscalculations or mistakes. This approach will raise questions about your ability and motivation. To the best of your knowledge, the data presented should be accurate. Weaknesses should never be mentioned without introducing methods to correct them or plans to do so. This does not mean that fundamental weaknesses should be hidden, just that in preparing your plan, you should develop approaches to remedy them and present with clarity.

A good business plan can be understood by the technical layman

Some entrepreneurs believe that they can impress their readers with profuse technical detail, elaborate blueprints, and the small print of an analysis. They are mistaken. Only rarely are technical experts called to evaluate this data carefully. In most cases, a simplified explanation, sketch, or photograph is appreciated. If technical details on the product or manufacturing process must be included, you should put them in the appendix.

A good business plan is written in one consistent style

Several people usually work together to produce the business plan. In the end, this work must be integrated to avoid creating a patchwork quilt of varying styles and analytical depth. For this reason, it is best to have one person edit the final version.

A good business plan is your calling card

Finally, your business plan should have a uniform visual layout. The fonts, for example, should be consistent with the structure and contents, effective graphics neatly integrated and, perhaps, a header with the (future) company logo used.

3.3. The investor's point of view

The entire start-up process must focus on successful capital acquisition. Professional investors are the first real acid test of the chances your business concept will have. Address your communication entirely to them, and learn to think like they do. They will not be satisfied with a mere description of your business concept, even if it is brilliant.

What is venture capital?

Venture capital is the money that is made available by venture capital companies or individuals to finance new businesses. Typically, such projects have a high chance of being profitable, while facing an equal risk of incurring loss. Experience shows that of 10 businesses financed with venture capital, only one will triumph, three will manage to eke out an existence, three will waste away, and three will be a total loss. It is only natural for venture capitalists to do everything in their power to generate profits in line with the risk ventured. Accordingly, they back up a project very intensely in order to harness as much potential as possible (Exhibit 7).

VENTURE CAPITAL PARTICIPATION IN THE VARIOUS START-UP PHASES

	Early phase		**Growth phase**		**Transition to established company**
	Seed	**Start-up**	**Growth stage**	**Bridge stage**	**Exit**
When ?	Before start-up	At or shortly after start-up	At first or second growth spurt, IPO still far off	6-12 months before IPO	As a rule, 5-8 years after start-up
What for?	Mainly to develop business concept further	E.g., for product development, initial marketing activities	To finance growth	To cover financial needs until sale of stock to public	Recovery of invested venture capital for reinvestment in more start-ups

Exhibit 7

What do venture capitalists look for?

Venture capitalists look for a number of important pieces of information in a business plan:

- **Management experience and competence.** All investors pay particular attention to who will be managing the enterprise. When all is said and done, the ability of management to implement the concept is a major determinant of whether a business survives or fails. Particularly in industries where innovation is critical, the focus is on the proper mix of all necessary management skills that one person alone will rarely have. Entrepreneurial experience is more highly valued than academic degrees. Another test of a worthwhile investment is the ability of management to work as a team.

- **A well-defined and, where possible, quantifiable customer value.** In its simplest form, this means lowering the cost of delivering an existing value or creating a new value, if this can be achieved at reasonable cost.

- **Innovative product or service range.** The product, service, and/or business system must possess a high degree of innovation.

- **The possibility to protect/sustain the innovation.** An important competitive advantage to your company could be a patented idea.

- **A growing and/or large market**. Venture capitalists prefer start-ups that demonstrate a potential to achieve significant sales of approximately $30 million within 5 years.

- **An effective concept for capturing a clearly defined target customer segment**. Potential investors want to see that you have a clear understanding of your market and how you intend to reach your customers. Your forecasts and estimates should be based on well-founded, persuasive assumptions and facts.

- **A far-sighted analysis of the competition.** Investors aren't naive – so don't even try to claim that your product has no competition. A complete and objective description of existing and potential future competitors, however, shows that you are aware of the risks you are taking which, in turn, will inspire confidence in you. Here again, having an idea that can be protected by law (patented, trademarked) is an advantage.

- **A careful weighing of the risks and opportunities.** Investors hate surprises, especially negative ones. A realistic description of the risks you face and how you plan to overcome them is far more credible than looking at the future through rose-colored glasses.

- **Detail possible exit routes.** Investors want to know from the outset when their commitment will end and how they will recover their investment. Generating a profit is always the object and the purpose of investor participation. The more productive options you can show them for how to do this, the better. The main possibilities include going public or selling shares to the other partners or to other companies.

What do venture capitalists do for the new company?

Venture capitalists play a number of roles (see Exhibit 8). But they will also take over the reins if the business does not achieve its targets. How should you choose a venture capitalist? Venture capitalists generally expect to have a high stake in the new company. In return, they provide support that goes far beyond a financial commitment and often shoulder a great deal of responsibility for the success of the venture. But potential investors do differ, and the company team should know its investors well. If you would rather own 20% of a $100 million company than 80% of a $5 million operation, you will have to choose your investor according to more criteria than just who will provide the most money at the best rate.

POSSIBLE ROLES OF VENTURE CAPITAL COMPANIES

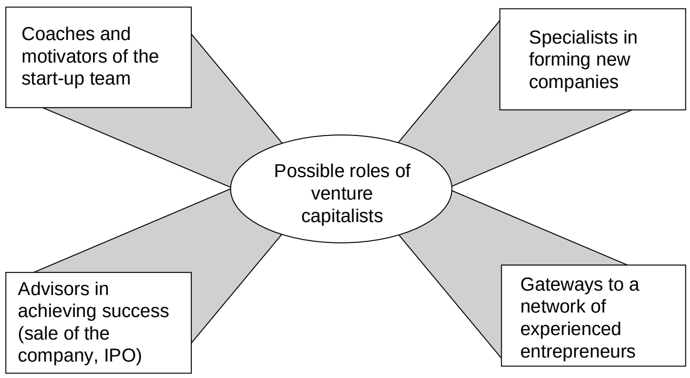

Exhibit 8

3.4. Tips on preparing a professional business plan

Investors are interested in the finished plan, not the process you went through to produce it. They prefer to see a well-prepared document from which they can gain a good sense of the risks and opportunities involved on the first read-through. When preparing your plan, the themes of customer value and potential return should run through the descriptions of your business objectives.

The three phases of the competition provide a general structure for preparing your plan. The three phases build upon one another such that the contribution for a previous phase will become a major portion of the following phase, supplemented with additional elements. How you carry out the work within each phase is up to you. The following tips are designed to help you.

Plan your approach

Drawing up a business plan is a very complex undertaking. Many variables must be considered and analyzed systematically, in a logical order. A detailed outline should be made as soon as the first ideas are laid down. It is smart to do your planning along the lines of a business plan, or according to your business system (e.g., R&D, production, marketing, sales, delivery, and administration). You should also number your topics and note any references. Using a word processing program with a spreadsheet is helpful. All reference material should be sorted by topic. Do the same with notes from discussions.

Tailor key questions to your specific project

Using a set of questions is helpful in preparing your business plan. Which questions should be asked and which answers included in the plan is determined by the type of value created, the product, service, or degree of technological sophistication, and what the readers need to know. You can use the sample questions provided in this Guide to write your own series of questions. These questions are only examples designed to get you thinking; they should not be taken as an exhaustive list of possible questions.

In other words, you are neither required to answer each question, nor must you reply to all questions in equal depth. It is up to you to decide which questions are relevant to your undertaking and necessary to understand it. You must also consider whether there are other questions to be answered beyond those that have been provided.

Focus on the final product

In projects of this kind, there is always a danger of getting lost in the details of each analysis. Step back from time to time and ask yourself whether the data provided is not already sufficient and whether further analysis will really be beneficial.

We also recommend that you limit the length of the results for each of the three competition phases. You will save a lot of time and energy if you stick to the recommended lengths from the beginning of your planning.

Seek support early

Gathering support from many different parties will be important in this competition. Teaming up early is one such form of support. Teams with complementary technical and entrepreneurial experience can delegate assignments according to the talents of the individual team members. This will help ensure that the work will be performed efficiently.

Do not hesitate to seek help from outside sources as soon as you need it. Contact experts and experienced entrepreneurs whom you meet at competition events or call the EnterPrize office for assistance.

Keep testing your plan

A winning entry will be easy to understand and follow. Therefore, it is important to present your idea to a test audience along the way. People outside the competition who critique your plan before you submit it can identify weaknesses and even give your work fresh impetus.

4. STRUCTURE AND KEY ELEMENTS OF A BUSINESS PLAN

Despite their many differences, all business plans have certain elements in common that all potential investors expect to find (Exhibit 9). Additionally, an appendix is often included that contains detailed information, often presented in the form of tables or graphs. Within this more or less required structure, the business plan is free to grow in its own direction. At the beginning, you will only work on a few key elements and individual topics. New elements are added with each additional phase, while the topics from the previous phases are expanded, and, gradually, the plan fills with content. At the end of the third phase, the individual analyses form a whole whose individual parts correspond to one another.

Exhibit 9

4.1. Executive summary

"A good executive summary gives me a sense of why this is an interesting venture. I look for a very clear statement of the long-term mission, an overview of the people, the technology, and the fit to market."
Ann Winblad, Venture Capitalist

The executive summary is designed to pique the interest of decision makers. It should contain a brief overview of the most important aspects of the business plan. In particular, it should highlight the product or service, the value to the customer, the relevant markets, management expertise, financing requirements, and possible return on investment.

Venture capitalists look at the executive summary first, though they usually just skim it. The quality of the summary itself is not likely to make them invest in your project, yet it can convince them not to. A clear, objective, and concise description of your intended start-up, which must be easy to comprehend, especially by the technical layperson, will show them that you know your business. Therefore prepare your summary with the utmost care; it may well decide whether the rest of your business plan is read.

The executive summary is an independent element of the business plan: Do not confuse it with the introduction of your business concept on the title page. Look at your executive summary with a critical eye – repeatedly – especially after all other aspects of your business plan have been completed. Ask yourself if you have described your business idea as clearly, compellingly, and concisely as you can.

Your readers should be able to read and comprehend the summary in five to 10 minutes. Test it. Give your executive summary to someone who has no previous knowledge of your business concept or its technical or scientific basis.

KEY QUESTIONS: Executive summary

Phase 1

- What is your business idea? In what way does it fulfill the criterion of uniqueness?
- Who are your target customers?
- What is the value for those customers?
- What market volume and growth rates do you forecast?
- What competitive environment do you face?
- What additional stages of development are needed?
- How much investment is necessary (estimated)?
- What long-term goals have you set?

Phase 2

- How high do you estimate your financing needs?
- What are the sales, cost, and profit situations?
- What are the most important milestones along the way to your goal?
- What test customers have you approached/could you approach?
- What distribution channels will you use?
- What partnerships would you like to enter into?
- What opportunities and risks do you face?
- What is the picture on patents?

Phase 3

- Summarize the results of your detailed business planning and state your exact financing needs!
- How will you delegate management tasks?
- How much production capacity is necessary?
- How will the implementation of your business idea be organized?
- List your next, concrete steps!

4.2. Product or service

"If you don't know what the customer value is,
the whole thing's a waste of time."
Bruno Weiss, Entrepreneur

Your business plan derives from an innovative product or service and its value to the end consumer. It is important to indicate how your product differs from those that are now or will be on the market. A short description of how far development has progressed and what still needs to be done is also essential.

Customer value

It doesn't make any sense to start up a new business unless the product or service is superior to current market offerings. Be sure to discuss in detail the function the product or service fulfills and the value the customer will gain from it.

If comparable products and services are already available from your competitors, you must convincingly substantiate the added value your customers will receive from your start-up. To do so, put yourself in the place of the customer and weigh the advantages and disadvantages of your product over the others very carefully, applying the same criteria to all.

If you are offering a range of innovative products or services, categorize them into logical business areas according to product or customer. Define the business areas in detail so there is no overlap.

Development status of the product/service

In explaining this issue, imagine you are the venture capitalist who wants to minimize the risk involved in participating. Try to refrain from including technical details and describe everything as simply as possible. A finished prototype will show your potential investor that you are up to meeting the technical challenge. If it enhances the understanding of your product, include a photo or sketch in your business plan. It is even better to have a pilot customer who already uses your product or service.

You should also explain the nature of the innovation itself and the edge you have over competitors. This is the point at which you should address the subject of patents for protection from duplication or imitation, or the protection of a model through registration. If there are still problems or issues to cover regarding development, be sure to mention them and how you intend to overcome these difficulties.

Regulatory requirements on products and services pose another set of risks. Note any permits you have obtained, have applied for, or will apply for, such as those of technical control associations, the postal service, or the department of health.

KEY QUESTIONS: Product or service
Phase 1

- What end customers will you address?
- What are the customer's needs?
- What customer value does your product/service provide?
- What is the nature of your innovation? What is the current status of technical development?
- What partnerships are necessary to achieve full customer value?
- What competitor products already exist or are under development?
- Is your product/service permitted by law?
- What are the prerequisites for development and manufacturing?
- What stage of development has your product or service reached?
- Do you have patents or licenses?
- What further development steps do you plan to take? What milestones must be reached?

Phase 2

- What versions of your products/services are designed for what customer groups and applications?
- What patents/licenses do the competitors have?
- Do you need to obtain licenses and, if so, from whom and at what cost?
- What kind of service/maintenance will you offer?
- What product or service guarantees will you grant?
- Compare the strengths and weaknesses of comparable products/services with yours in an overview!

Phase 3

- What resources (time, personnel, materials) do you require for each subsequent development?
- What share of sales do you expect from your various products/services (if applicable)? Why?
- What income from royalties/sales do you estimate from possibly marketing the property rights? Who would be your licensees/buyers?

4.3. Management team

"I invest in people, not ideas."
Eugene Kleiner, Venture Capitalist

The management section is often the first part of the plan that venture capitalists turn to after reading the executive summary. They want to know whether the management team is capable of running a promising business. Entrepreneurs frequently underestimate the significance of this question and make the mistake of skimping on content and making do with meaningless phrases.

Take the time to describe your management team well. When discussing management's qualifications, be sure to emphasize those that are particularly important for implementing your specific plans. Professional experience and past success carry more weight than academic degrees. If key positions are to be given to inexperienced staff members, explain this decision in detail.

CHARACTERISTICS OF A POWERFUL MANAGEMENT TEAM

- Common vision: Everybody wants to succeed
- Complementary attributes and strengths
- At least three, but usually no more than six, people
- Sticks together through thick and thin
- Staying power, even when there are setbacks - regroups and makes a second or even third attempt to clear the hurdle

Also explain how the responsibilities in the company are to be delegated and indicate which positions still require reinforcements. It is particularly helpful to compare the assignments to be filled with the skill profiles of current team members. Do not hesitate to name your most influential advisors. No one will have all the qualifications and experience necessary to found a company. Considerable involvement on the part of advisors such as experienced entrepreneurs, accountants, PR firms, or management consultants is a sign of professionalism and will reassure the venture capitalist that you have all the contacts you may need.

WHAT PROFESSIONAL INVESTORS LOOK FOR

- Has the team already worked together?
- Do team members have relevant experience?
- Do the founders know their weaknesses and are they willing to make up for them?
- Have the founders agreed on their future roles? Are ownership issues settled?
- Has the management team agreed on a common goal, or are there underlying differences of opinion?
- Do the individual team members fully back the project?

Finally, although the management team will not be evaluated until the third phase of the business plan competition, it is advisable to begin looking for suitable partners as soon as possible. Bringing together just the right people to form a "dream team," so to speak, is immensely important for later business success and, therefore, requires a great deal of time and care.

KEY QUESTIONS: Management team
Phase 3

- Who are the members of your management team and what distinguishes them: education, professional experience, success, standing in the business world?
- What experience or abilities does the team possess that will be useful for implementing your concept and setting up your company?
- What experience or abilities are lacking? How will the gaps be closed? By whom?
- What goals do the team members pursue by starting up the business?
- How high is the motivation of each individual team member?

4.4. Market and competition

"If there is no competition,
there is probably no market."
Brian Wood

Thorough understanding of your customers and their needs is the foundation of every successful business. For it is the customers who give your company a reason for being. And in the end, by buying – or not buying – your product, or service, they will decide if and how successful your company will be. Only those customers who are convinced they are getting a greater value than they would from a competing product, or by not buying a product at all, will buy your product. Knowing your market and competition well is thus critical to the success of your undertaking.

Market size and growth

A dramatic increase in the value of the company can be expected only if the market holds great potential. The market size should be presented in figures representing the number of customers, unit sales, and total dollars in sales. Your expectations for market growth are critical. You should also indicate what main factors are now influencing or may influence the given industry segment. Show what factors will affect developments (technology, legislative initiatives, etc.) and what relevance these factors have for your business. Work with a focus in order to save yourself some energy: Work with hypotheses, make a list of questions you want answered, what information you will need, and where you might find it.

The external data necessary for an analysis are often easier to obtain than you might think. Be creative and determined; make use of all possible sources including trade literature (journals, market studies, scholarly essays), industry directories, associations and government agencies (statistics offices, chambers of commerce, patent offices), banks for industry surveys, databases, the Internet (keep your searches focused), and, of course, interviews. It often helps to call around. Using a short discussion outline will increase your efficiency and productivity, as well as the willingness of your party to disclose information.

This collection of individual pieces of data seldom provides a direct answer to your questions – you will have to draw well-founded conclusions or make sound estimates. When making an estimate, observe the following:

- **Build on a solid foundation**. There may be many unknowns, but if you rely on easily verifiable figures, your estimate will be harder to topple.
- **Think logically**. An estimate should be a logical conclusion (i.e., it should not have any leaps in logic or depend on unspecified assumptions).
- **Compare your sources**. Check your facts, such as statements made in an interview, with a number of different sources if at all possible.
- **Be creative**. The shortest distance to your goal is not always a straight line. For example, when a variable is unknown, look for a substitute variable that relates to the one you need.
- **Check for plausibility**. For each estimate, ask yourself, "Does this result really make sense?"

Market segmentation

Follow up your general explanations with your choice of target customer and your planned market success (sales volumes, sales revenues, market share, and profit). To do this, you must segment your market. The choice of segmentation criteria is up to you, as long as you are certain that the number of customers in each segment - as well as their behavior - can be determined, and that the customers within each segment can be reached by means of the same marketing strategy.

Possible customer segmentation criteria for the consumer goods markets:

- Location: country, urban / rural (population density)
- Demographics: age, sex, income, profession, company size
- Lifestyle: techies, counterculture, active seniors
- Behavior: frequency of product use, product application
- Buying habits: brand preferences, price consciousness

Possible customer segmentation criteria for industrial goods markets:

- Demographics: company size, industry, location
- Operations: technology employed (e.g., digital, analog)
- Buying habits: centralized or decentralized purchasing, purchasing criteria, supplier agreements
- Situational factors: urgency of need, order size

Define the potential sales revenues for a given period per segment. Take your sales strategy and the behavior of the competition into consideration. Depending on the industry, you may also want to allow for price erosion.

Competition

Define the strengths and weaknesses of your competitors. To do this, evaluate your major potential competitors using the same criteria, such as sales volume and revenues (pricing), growth, market share, cost positioning, product lines, customer support, target groups, and distribution channels. In the interest of brevity, forgo the use of a great deal of detail. Evaluate your own company according to these same criteria and make a comparison as to how sustainable your competitive advantage will be.

Positioning vis-à-vis the competition

Why should a potential customer buy your product and not that of your competitor? Because it offers greater value (in some aspect that is important to the customer) than competing products; because it is objectively or emotionally "better;" or, as marketing experts would say, you have developed a value proposition or unique selling proposition for your business idea.

Formulating this value proposition and anchoring it firmly in the mind of the customer is the main task of marketing communication. Marketing experts talk about the positioning of a product, brand, or business. Well-positioned products leave consumers with a particular impression. The most important guideline for positioning is, therefore, to look at the product from the customer's point of view. The point is to meet a need better, not to present new product attributes. The advantage to the customer must be immediately clear, memorable, and important. At the same time, your positioning must be distinctive from that of competitors. Only then can customers connect the value proposition that you offer with the name of your product or business and buy your product. The following guidelines may help:

- Identify relevant customer needs or problems
- Define clear customer segments of sufficient size
- Design an attractive range of products and services
- Make yourself unique through differentiation from the competition
- Address the subjective perception of the customer
- Ensure customer satisfaction even after purchase

Because positioning is so critical to the market success and, therefore, to the long-term success of your business, you should pay particular attention to it. Persuasive positioning will not come about immediately, it will be a result of intense effort and will need frequent revision to achieve the maximum effect. The point of departure for positioning is the product itself. Additional insight will be found as you refine and modify your product during development and respond to new revelations as a result of customer surveys.

KEY QUESTIONS: Market and competition

Phase 1

- How is the industry developing?
- What factors are decisive for success in your industry?
- What role do innovation and technological advances play?
- How will you segment the market?
- What market volumes do the individual market segments have, now and in the future (rough estimates)?
- Who are your target customer groups?
- What customer examples can you give?
- What major competitors offer similar products/services?
- What new developments can be expected from competitors?
- How sustainable will your competitive edge be?

Phase 2

- What market volume (value and amount) do you estimate for your individual market segments over the next 5 years?
- What will influence growth in the market segments?
- What is your estimate of current and future profitability of the individual market segments?
- What market shares do you hold in each market segment?
- What segments are you targeting?
- Who are your reference customers? How do you plan to get reference customers?
- What role do service, consulting, maintenance, and retail sales play?
- How much do you depend on large customers?
- What are the key buying factors for customers?
- How does the competition operate? What strategies are pursued?
- What are the barriers to market entry and how can they be overcome?
- What market share does your competition have in the various market segments?
- What target groups do your competitors address?
- How profitable are your competitors?
- What are your competitors marketing strategies?
- What distribution channels do your competitors use?
- How sustainable will your competitive edge be? Why?
- How will competitors react to your market launch? How will you respond to this reaction?
- Compare the strengths and weaknesses of your major competitors with your own in the form of an overview!

4.5. Marketing and sales

"Marketing is far too important
to be left to the marketing department."
David Packard, Entrepreneur

Key elements of a well-conceived business concept are well-planned marketing and sales activities. They require a persuasive description of your strategies for market launch, marketing, and the measures planned for sales promotion. A skeleton framework to follow is that of the four "Ps": product, price, place, and promotion.

1. Product

Your original product idea has already given you some sense of the characteristics of your product. After a closer analysis of the needs of various customer segments, you now must evaluate whether your product actually meets them or to what extent it may require adaptation. This raises the question of whether you should manufacture one single product for all segments or whether you want to adjust the product to meet the needs of individual segments.

2. Price

The basis for an attainable price is the willingness of customers to pay the price asked of them. This contradicts the conventional wisdom that price is derived from costs. Of course, cost is a considerable factor, but the cost-price ratio only becomes critical when the price asked will not cover costs within the foreseeable future. In this case, it is advisable to get out of the business as quickly as possible or, better yet, never to go into the business in the first place.

The price you can ask depends entirely on how much the value of your product is worth to the customer. You have defined, and perhaps quantified, the customer value in the business concept or product description. Now define a price bracket based on the quantified customer value of your product. You can verify and refine your assumptions through discussions with potential customers.

The pricing strategy you choose depends on your goal: Do you want to penetrate the market quickly by going with a low price (penetration strategy)? Or, do you want to generate the highest possible return from the out-set (skimming strategy)?

New companies generally pursue the skimming strategy for good reason:

- A new product is positioned as "better" than previous options, so a higher price can be justified.

- Higher prices generally lead to higher profit margins and allow the new company to finance its own growth. New investments can be financed out of profits and outside investors are no longer needed.

- Unlike the skimming strategy, the penetration strategy generally requires high initial investment in order for supply to meet the high demand. This heightened investment risk is something investors usually prefer to avoid.

Certain situations make following a penetration strategy the better choice:

- **Setting a new standard.** Netscape distributed its Internet browser free of charge, thus setting a standard. With the Macintosh, however, Apple followed a skimming strategy and missed the chance to establish the Mac as the new standard.

- **High fixed costs.** Businesses with high fixed costs are forced to find a wide audience as quickly as possible to make those costs worthwhile. Fixed costs at Federal Express, for example, for air transport and sorting facilities, are the same whether they deliver thousands or many millions of letters.

- **Competition.** If the entry barriers are low and tough competition is likely, a penetration strategy is the best way to be faster than the competition in capturing a large market share. Such cases naturally also raise the question as to whether this type of business is appropriate for a start-up.

3. Place

Your product or service will somehow have to reach the customer physically. Although this may sound simple, it involves another monumental marketing decision: In what way, via which distribution channel, do you want to deliver your product?

The choice of distribution channel is influenced by various factors, such as how many potential customers will you have? Are they companies or individuals? How do they prefer to shop? Does the product require explanation? Is it in an upper or lower price bracket? Basically, you will have to consider whether your company will handle distribution itself, or whether a specialized operation will handle it for you. This sort of "make-or-buy" decision will have a significant impact on both the organization and the business system of your enterprise. The choice of distribution channel is thus closely related to other marketing decisions and will, in turn, affect other measures.

Distribution can be roughly categorized into two forms: direct or multi-channel. Technological developments, particularly in information technology, have greatly expanded the spectrum of distribution channels over the past few years. Here is a selection:

- **Third-party retailers**. Products are sold via retailers who have easy access to potential customers. Here, it is important to acquire a good shelf position, which is obviously also sought by the competition and is accordingly expensive. The product must also offer retailers an attractive profit if they are to include it in their range at all.

- **Outside agents**. Specialized companies act as agents for the distribution of products from various manufacturers. They take over the function of the in-house sales person. Outside agents are relatively expensive, although only for the sales they conclude successfully. They make no commission if they do not sell the product, making them an attractive channel for new companies since risk is limited. Good agents, however, are not always easy to find.

- **Franchising**. A business concept is put into practice independently by a franchisee who pays a licensing fee, whereby the franchiser maintains control of the business policies (McDonald's is an example). Franchising enables rapid geographic growth, while ensuring control of the sales concept without huge personal investment.

- **Wholesalers.** It can be difficult for a small company to maintain contact with a large number of retailers. A wholesaler who has good contacts to the retail trade can take over this activity, helping to improve market penetration while lowering distribution costs. On the other hand, wholesalers often demand a cut for their efforts.

- **Stores**. Selling in your own store is a good choice when the design of the purchasing experience is central to the product, and only a small number of stores is necessary to cover the market. Independent shops will require investment, but will also allow the greatest control over distribution.

- **Own sales staff**. Sales agents are above all deployed when the product is complex (e.g., capital goods), requiring extensive knowledge of the product. Face-to-face customer visits are expensive; the number of customers must be fairly small. Having your own sales staff as the distribution channel is relatively expensive and only worthwhile for involved products.

- **Direct mail**. Select customers receive a mailing through the postal service. Addresses can be purchased from database companies and sorted according to desired criteria. The success of the direct mailing depends on whether the reader feels an immediate appeal – otherwise, it lands in the wastebasket.

- **Call center**. Through advertising, customers are invited to order a product by telephone. Simple products can be distributed to many customers in this way, with no need to set up stores throughout the entire sales region. You can also hire the services of specialized call center operators.

- **Internet**. The Internet is a relatively new marketing channel, through which a global market can be reached at minimal cost.

4. Promotion

Before potential customers can appreciate your product, they have to hear about it. And to achieve this, you must advertise to attract attention, inform, persuade, and inspire confidence. Those are the objectives of communication. Communication must explain the value of your product or service to your customers, as well as convince customers that your product meets their needs better than competing or alternative solutions. There are various ways of getting the customer's attention:

- Classic advertising: newspapers, magazines, trade journals, radio, TV, movie theaters
- Direct marketing: direct mail to select customers, telephone marketing, Internet
- Public relations: articles in print media about your product, business or you, written by you or a journalist

- Exhibitions, trade fairs
- Customer visits

Communication is expensive, so make the most of it. Calculate exactly how much advertising you can afford per sale and choose your communication messages and media accordingly. Focused communication yields the best results. When you address your customers, focus on the people who make the purchasing decision or have the greatest influence on the purchasing decision.

KEY QUESTIONS: Marketing and sales

Phase 1

- What final sale price do you want to charge (estimated)? What criteria did you use to arrive at this final sale price? How high is the profit margin (estimated)?
- What sales volumes and sales revenues are you aiming for (estimated)?

Phase 2

- In which partial market segments will you make your market entry? How do you plan to turn this “toehold” into a high-volume business?
- What sales volumes are you targeting (detailed data by market segment)?
- Describe the typical process of selling your product/service. Who, among your buyers, ultimately makes the purchasing decision?
- What target groups will you reach by what means of distribution?
- Do you want to penetrate the market quickly with a low price, or bring in the highest return from the start? Explain your decision!
- How will you draw the attention of your target groups to your product or service?
- How will you woo reference customers?
- How much, in time and resources, will it cost to acquire a customer?
- What advertising materials will you use to do so?
- What part do service, maintenance, and hotlines play?
- How difficult will it be and/or what will it cost to create long-lasting customer loyalty?
- What other planning steps are necessary in the run-up to launching your product/service? Draw up a schedule with the most important milestones!

Phase 3

- What demands (employee number, qualifications, and outfitting) must the operation meet in order to effectively implement its marketing strategy? What is your estimated expenditure for this area?
- How will sales volume and operating results be spread out among the various distribution channels (estimated)?
- Which market share per distribution channel do you plan to capture?
- What are your expenses? At launch – and later.
- What price will you charge for your product/service per target group and distribution channel?
- What payment policies will you lay down?

4.6. Business system and organization

"Organizations exist to enable ordinary people to do extraordinary things."
Ted Levitt, Editor, Harvard Business Review

Business system

Every entrepreneurial assignment is comprised of the interplay of a number of individual activities. When they are presented systematically in relation to one another, a business system results. The business system model maps out the activities necessary to prepare and deliver a final product to a customer. For clarity's sake, they are grouped into functional blocks. Devising a business system is a good way to understand the business activities of a company, think them through systematically, and display them with transparency. A generic business system common to nearly all industries and enterprises is shown in Exhibit 10.

GENERIC BUSINESS SYSTEM

Exhibit 10

Use the above model as the starting point for designing your own business system. You will need to adapt it to your own situation and make it concrete in order to put it into practice. For a manufacturer, for example, it may be useful to subdivide the production category into separate stages, such as purchasing, raw materials processing, component manufacture, and assembly. You may also need to separate sales into logistics, wholesale distribution, and retail sales, for example.

An individual plan will be appropriate to each case, depending on the industry in which you operate and, of course, the business itself. The business system of a computer manufacturer will be very different from that of a fast food chain. And the business system of a department store may look quite different from that of a direct merchandising company although both will sell many of the same products. There are no general rules or standards for a business system. Your own system should be logical, complete, and useful for planning – just don't let it get too complicated.

Concentrate on the major activities in your business system. A team of three to five will not be able to cover all tasks themselves, either because they do not have the abilities or because they could not do so with the necessary efficiency. Together with your management team, think carefully about what activities really create something new and how you and your staff can best make use of your time to create the highest value for your customer and get ahead of the competition. The buzzword here is *focus*. Once you have determined which activities make up your business system, choose those which you can execute better than anyone else. A trend toward specialization can be observed in many industries.

Specialization is particularly important for start-ups. They should concentrate all their energy on just a few select activities in the business system. At the beginning, even software giant Microsoft concentrated solely on the development of the DOS, leaving all other activities in the business system up to IBM.

Organization

In addition to a business system, you will need to consider several other organizational issues. It is essential that tasks and responsibilities be clearly delegated and that you design a simple organization with few levels. The rest will follow as needed during operation. Your organization must be flexible and always adaptable to new circumstances. Be prepared to reorganize your company repeatedly during the first few years. Decide who is responsible for what in each business area (delegation of tasks and responsibilities). As soon as you have set up the interdisciplinary functions - such as a management, human resources, finance, and administration - you'll be up and running. If you keep your organization simple, each staff member will know which assignments he or she must complete and can carry them out independently. On the other hand, everyone should be in a position to fill in for another team member for a short time if necessary. (See Exhibit 11)

SAMPLE START-UP ORGANIZATION

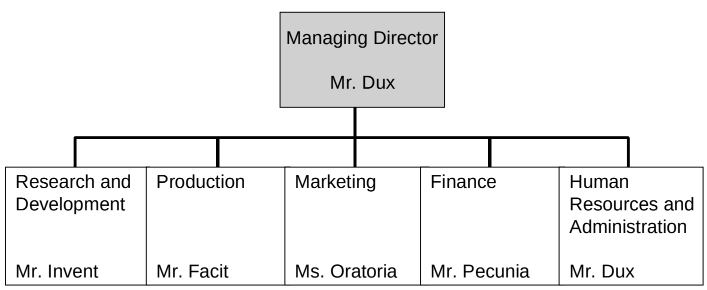

Exhibit 11

Business location

Describe briefly the choice of location for your business. Do not enter into a long-term rental agreement, as your business may have to move in response to the growth you anticipate. You may have to make this move fairly quickly.

"Make or buy" and partnership decisions

Once you have determined the core of your business and have drawn up the necessary business system, you will have to think about who will best carry out the individual activities. Activities outside your chosen focus should be handled by third parties. But supporting activities within the new company do not necessarily have to be carried out by you. These may include bookkeeping or human resources. For each activity, the question to ask is: Do we do it ourselves, or have someone else do it - to make or to buy?

Make-or-buy decisions need to be conscious decisions taken after weighing the advantages and disadvantages. Supplier partnerships, for example, cannot be dissolved from one day to the next, and some partners cannot easily be replaced if, for some reason, they are no longer available. When considering make-or-buy decisions, rely on the following criteria:

- **Strategic significance**. Those aspects of performance that make a major contribution to your competitive advantage are of strategic importance to your business. They must remain under your control. A technology company could hardly relinquish research and development, and a consumer goods manufacturer would never give away its marketing activities.

- **Suitability**. Every business activity demands specific abilities that may not be available within the management team. Your team must, therefore, consider whether in specific instances it is best to carry out a particular task, acquiring the necessary abilities, or whether it would be better to hand over the task to a specialized company. Specialists may not only be able to carry out the assignment better, they may also be able to offer a cost advantage thanks to higher production volumes.

- **Availability**. Before you make a decision to buy, you need to find out whether the product or service is available in the form or with the specifications you require. Negotiate, whenever possible, with several suppliers. You will usually find the best terms in this way and will learn more about the service you are buying. Often, you can help a supplier improve its performance. If you cannot find someone to supply what you need, you may find a business partner who is willing to acquire the necessary skills to do so.

The question for a start-up is how you want to cooperate with other companies. Every partnership has its advantages and disadvantages.

- **Informal, non-binding partnerships** represent no great obligation for either side. Both parties can end the partnership quickly and easily. But they must also live with the knowledge that supply or demand could dry up just as quickly. Furthermore, suppliers will not be able to meet all the special needs of a customer since they can not sell tailored products to all their customers. Casual partnerships are typical for mass products, every-day services, and standardized components for which replacement buyers and sellers are easily found.

- **Close partnerships** are sometimes characterized by a high degree of interdependence. They are typical of highly specialized products and services or high trade volumes. In these situations, it is usually difficult for both sides to change partners or to buy or sell large quantities of special parts within a short time period. The advantage for both sides is the security of a binding relationship and the possibility of concentrating on one's own strengths, while benefiting from the strengths of partners.

In order for a partnership to develop into a successful business relationship, a number of factors must be considered:

- **Win-win situation**. Both sides must be able to gain a fair advantage from the relationship. Without an incentive for both sides, a partnership cannot be sustained.

- **Risks and investments**. Partnerships involve risks that are usually brushed aside when business is going well. A supplier with an exclusivity agreement can, for example, end up in a difficult situation if the buyer suddenly cuts back production and purchases fewer components. This is especially true if the supplier has acquired specialized production tooling that cannot immediately be used for other orders and buyers. Conversely, a buyer can face difficulties if a major supplier ceases to deliver (bankruptcy, fire, strike, etc.). Such risks and possible financial consequences must be thought through from the outset and perhaps regulated by contract.

- **Dissolution**. As in interpersonal relationships, business relations can also suffer tension and result in irreconcilable differences. Make sure to lay down in detail under which conditions a partner can withdraw from a partnership.

When working on your business plan, it is not too early to begin thinking about whom you may want to cooperate with and what form this may take. Partnerships will allow a young company to benefit from the strengths of established companies and focus on developing their own strengths. Through partnerships, you can usually grow faster than you could on your own.

KEY QUESTIONS: Business system and organization
Phase 2

- What does the business system for your product/service look like?
- What activities do you want to handle yourself?
- Where will the focus of your own activities lie?
- What business functions make up your organization, and how is it structured?
- What resources do you need (quantitative and qualitative) to create your product/service?
- How high is your need for technical input (raw materials, materials to create your service)?
- What will you make, what will you buy?
- Which partners will you work with? What are the advantages of working together for you and your partners?

Phase 3

- Where will you locate your business?

- What capacity for product manufacture and service production do you plan (number of units)?
- How much will production and delivery of your product/service cost?
- How, and at what cost, can you adjust your capacity in the short term?
- What measures are planned for quality assurance?
- If you need a warehouse, how will you organize your inventory?
- How much of your product has to be put in storage?
- How are your costs structured (fixed, variable)?

4.7. Implementation schedule

"Business is like chess: To be successful,
you must anticipate several moves in advance."
William A. Sahlmann, Professor

Investors want to know how you envision the development of your business. A realistic 5-year plan will inspire credibility among investors and business partners. Moreover, it will help you think through your various activities and interdependencies. You will endanger your business if you attempt to reach your targets with faulty and, above all, overly optimistic planning.

Drawing up your implementation schedule

Concentrate on the most major milestones and the most important interdependent events. The following three elements will usually suffice:

- Gantt implementation schedule (for a sample Gantt timeline, see CityScape case study)
- Major milestones
- Important connections and interdependencies between the work assignment groupings

Human resources planning

As your new business takes off, systematic personnel planning will become more and more indispensable. Growth will require you to recruit new employees who will have to be trained and integrated into the business. Maintaining a simply structured working environment will help you draw up clear job descriptions and seek just the right employees. Keep in mind that a qualified, specialized workforce may be difficult to find even in times of high unemployment. You will often not be able to avoid "stealing" good employees from competitors.

Include costs in your personnel planning in order to arrive at the total cost of human resources (wages and indirect labor costs) for the income statement in your business plan. The cost of personnel depends on a number of factors, such as the industry itself, employee qualifications, and age. Additionally, indirect labor costs can amount to over 50% of the wage.

Investment and depreciation planning

Investment and depreciation planning includes all investments that may be capitalized and the corresponding write-offs. The amount of depreciation depends on the service life planned for the property. Usually, property is written off in full over 4 to 10 years in equal annual amounts (straight-line method). Investments are to be included in the liquidity calculation, and the total amount of annual write-offs listed in the planned income statement.

KEY QUESTIONS: Implementation schedule
Phase 3

- What are the most important milestones for the development of your business, and when must they be reached?
- How do you plan to structure the work to reach these targets?
- Which tasks and milestones are interdependent?
- For which tasks/milestones do you anticipate bottlenecks?
- How many new employees will you need in the individual business areas over the next 5 years? What will this cost?
- How much real capital is necessary to achieve initial sales?
- List your planned short-term investments!
- List your planned longer-term (3 to 5 years) investments!
- What investments will be required when which milestones are reached?
- How high is the annual depreciation for each investment?

4.8. Opportunities and risks

"One of the greatest myths about entrepreneurs is that they are all risk seekers. All sane people want to avoid risk "
William A. Sahlmann, Professor

The object of this exercise is to identify a margin of error for departures from your assumptions. If possible with reasonable effort, it is advisable to draw up best-case and worst-case scenarios involving key parameters to identify the opportunities and risks. These calculations will allow venture capitalists to judge how realistic your plans are, and to better assess the risk of their investment.

Change various parameters in the scenarios (such as price or sales volumes) to simulate how a change in conditions might affect your key figures (sensitivity analysis).

KEY QUESTIONS: Opportunities and risks
Phase 2
- What basic risks (market, competition, technology) does your business venture face?
- What measures will you take to counter these risks?
- What extraordinary opportunities/business possibilities do you see for your company?
- How could an expansion of your capital base help?

Phase 3
- What will your planning look like for the next 5 financial years under both a best and worst case scenario?
- What effect will this have on your need for capital and your return?
- In your view, how realistic are these scenarios?
- What consequences do they have on your business planning?

4.9. Financial planning and financing

"Planning substitutes chaos for mistakes."
Unknown

Financial planning assists you in evaluating whether your business concept will be profitable and can be financed. To this end, the results of all preceding chapters must be compiled and consolidated. Projected growth in value results from the planned cash flows from your operative business. These are revealed through liquidity planning, which also provides information on your various financing needs. In addition, the profit situation of your business can be seen in the income statement. This statement is also necessary according to commercial and tax law. There are many ways to present the figures. The appendix contains sample tables of how to perform liquidity planning and make up an income statement, as well as a balance sheet.

Minimum required of financial planning in your business plan:

- A cash flow calculation (liquidity planning), income statement, balance sheet
- Forecasts over 3 to 5 years, at least 1 year beyond the point of breaking even, that is, beyond the generation of positive cash flow
- Detailed financial planning for the first 2 years (monthly or quarterly), thereafter annually
- All figures must be based on reasonable assumptions (only the main assumptions need to be described in the plan)

Planned income statement

Whether a company's assets grow or diminish depends on the bottom line at the end of a year. The income statement can help you forecast this. In contrast to liquidity planning (= planned cash flow), an income statement focuses on the issue of whether transactions lead to an increase (= revenue) or a decrease (= expense) in the net worth of your business (defined as the sum of all assets minus debt).

Go through your entire business plan and decide whether your assumptions will lead to revenues or expenses and, if so, how high they will be. If you are in doubt about the exact amount of costs your business will incur, gather quotes and estimates. Do not forget to cover the cost of your personal living expenses. In the case of a limited liability company, this would be the salary of your general manager.

List write-offs in your investment and depreciation planning. The cost of investments themselves (i.e., the purchase price of the investment) is not included in the income statement, because the amount paid out does not lead to a change in the net worth of the business.

Material costs comprise all expenses for raw materials, auxiliaries, expendable supplies, and purchased goods and services. Your planned human resources expenditure includes wages and salaries plus social security contributions and taxes and is listed under personnel costs. For the purpose of simplification, the category "other costs" is treated as a collective item, including among other things, rent, insurance, office supplies, postage, advertising, and legal counsel. When assigning individual revenues and expenses strictly observe legal regulations. Finally, calculate the difference between all revenue and expenses in a financial year, by which you will arrive at an annual net profit/loss. This will give you an overview of the operating result, but it will not give you a reliable assessment of your level of liquid funds. For this, you will need liquidity planning.

Sales of your product or service may be booked in the current financial year, even though payment does not occur until the next; you will need to list the sales revenue even though the money has not yet been deposited into your accounts. The same is true for expenses. The income statement is generally planned in annual intervals. To enhance the accuracy of your planning for the first year, you should make monthly forecasts, and quarterly forecasts for the second year. For the third, fourth, and fifth years, continue to make annual projections. You can make use of the tables contained in the appendix of this Guide to list the figures.

Liquidity planning

Your company must have a certain amount of cash on hand at any given time in order to avoid becoming insolvent, which leads to bankruptcy that will mean the financial ruin of your business. Detailed liquidity planning should help ensure a positive cash flow. The principle is simple: Receipts are compared directly to disbursements. Please note that writing or receiving an invoice does not mean that the money is already in your account or that you have paid the bill. Liquidity planning is concerned with the date of payment when the money actually comes in or goes out. Thus, liquidity planning involves only those transactions that cause a change in your cash reserves. Depreciation, liabilities, and non-market output are not included.

Lay out the amount and timing of all the payments you expect. Your company is solvent when the sum of its receipts is greater than the sum of its disbursements at any given time. You will have to draw on capital for those times when this planning does not cover all expenses. The sum of all these individual payments will equal the total capital required for that planning interval.

The farther you look into the future, the more uncertain your planning will be. Liquidity planning should thus be carried out every month for the first year, quarterly for the second year and only annually for the third, fourth and fifth years. The appendix of this Guide contains tables you can use for an exact compilation of the figures.

Projected balance sheet

Venture capitalists are interested in seeing how your assets are expected to grow as represented on a projected balance sheet. Here, the type and value of the assets are placed on the asset side of the balance sheet across from the source of the capital on the liabilities side. As with the income statement, there is a standard accounting format, required by law, for balance sheets. They are prepared at annual intervals. Again, the appendix of this Guide contains tables you can use for an exact compilation of the figures.

Financing needs

Liquidity planning enables you to determine the amount of capital you will need and when you will need it, but it does not indicate how these needs will be met. We basically distinguish between equity (investors have a stake in the business) and loan capital (which is borrowed from outside sources). Select the right mix for your business from the myriad sources of financing available to you (Exhibit 12).

"You can't get something for nothing," the saying goes - and the same is true of money. Your family may ask little in return for financial assistance; professional lenders are more demanding.

All the management team can offer investors for their cash is a promise – not exactly a good position from which to negotiate. Nevertheless, you have a good chance of being

SOURCES OF CAPITAL AT VARIOUS STAGES OF DEVELOPMENT

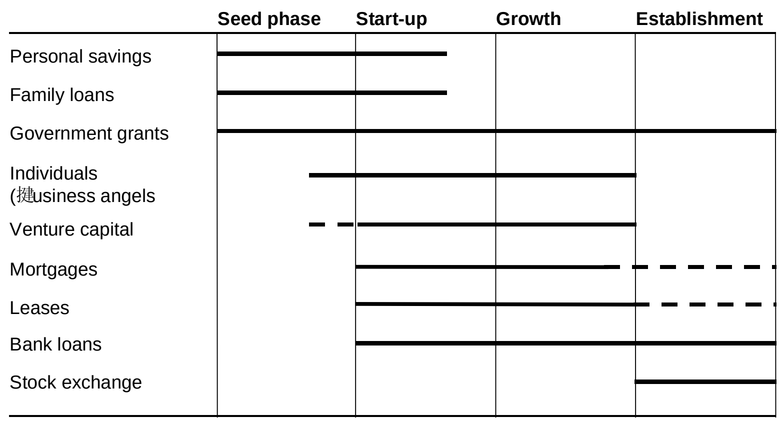

Exhibit 12

financially successful if business goes well, because professional investors also have an interest in top performance from the team. Be clear about your needs and expectations and those of your investors.

If you are seeking a long-term commitment and are satisfied with a small company, you are probably well advised to make use of family funds and loans from friends and banks. You will retain a majority shareholding, but you are significantly restricting your chances for growth.

If, however, you desire rapid expansion, you will want to procure venture capital. Venture capitalists will generally expect to obtain a large share of the company. You may, in fact, have to relinquish the majority of the equity. Professional investors, however, are not interested in managing the business as long as you meet your targets, even if they have the majority shareholding. They have, after all, invested in the management team in order to lead it to success. They will support you actively with their management skills and contribute specialty knowledge, such as legal or marketing expertise, ties, and contacts.

A deal can be very complicated. It is always advisable to contact experienced entrepreneurs and get the expert advice of trustees, tax advisors, and lawyers. You may also want to gather a number of bids from various investors. Do not be put off by complicated arrangements. There are usually legitimate reasons for them, such as tax breaks, control of the funds invested, etc. Be absolutely certain, however, that you understand all the details of the deal.

Calculating the investor's return

Investors evaluate the success of an investment by the return they get on the capital invested. As a result, anticipated return should be apparent at a glance in the business plan.

In the CityScape case study, for example, investors put a total of $2.5 million into the enterprise during its first 3 years ($0.9, $1.1, and $0.5 million, respectively). After 5 years, and listing on the stock exchange, realistic proceeds of approximately $25 million are expected. How high is the return in this case? (Exhibit 13)

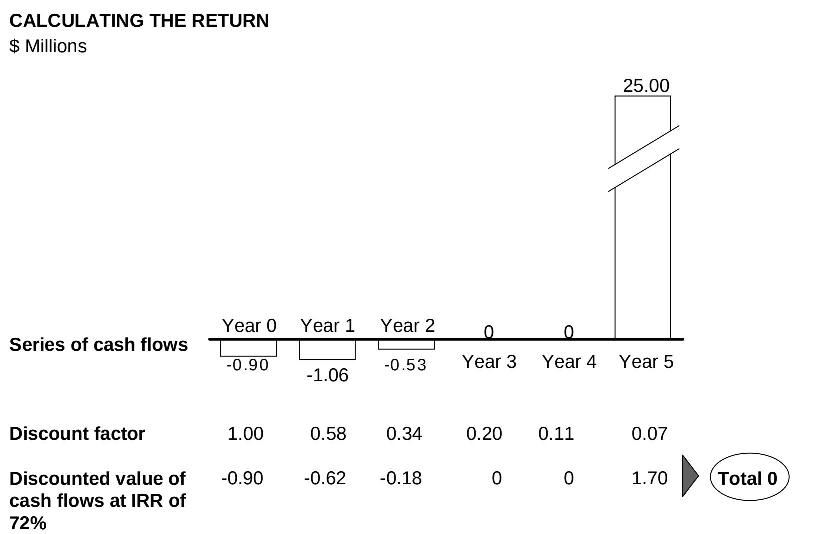

Exhibit 13

From the point of view of the investor, all funds contributed to a new company result first in negative cash flows. After a business breaks even, positive cash flows will not immediately be paid out in the shape of dividends, but will be first used to strengthen the balance sheet. Cash will be returned to the investors at realization. Because cash flows will occur over several years, they must be discounted, that is, calculated back to the present (interest and compound interest calculation). The discount factors for the various years can be arrived at using the following formula

$$\text{discount factor} = \frac{1}{(1+r)^T}$$

whereby r = the discount rate in percent and T = the year in which the cash flow takes place. To calculate the return, the internal rate of return (IRR) method is used. The IRR is the discount rate at which the sum of all positive and negative cash flows, discounted at present, results in zero. The IRR for the CityScape project example is 72%. That means that the investors get an annual return of 72% on their capital. This is a reasonable return considering the risk involved.

Most calculators and spreadsheets have a special IRR function with which to calculate the IRR (in Excel this is the IRR () function). It can also be calculated by hand.

Valuation of a company (i.e., working out how much a market is prepared to pay for shares when a business goes public) is an art in itself. A simple rule of thumb is that the value is six to eight times the cash flow or net profit (after taxes) of the business in the year of initial public offering. In the case of CityScape, a factor of six multiplied by the net profit in the fifth year ($4.2 million) was used, which results in a valuation of $25.2 million.

If you have no experience in financial planning, consulting with coaches or experts (e.g., tax consultants or accountants) is *highly recommended*. In particular, discuss the issues of turnover sales and income taxes, which have been simplified here, with a tax advisor at one of the competition events listed at the front of this Guide. Note that most business ventures fail due to lack of financial planning. If you don't have someone with the necessary skills on your team already, start looking!

KEY QUESTIONS: Financial planning and financing
Phase 3

- How will your revenues, expenses, and income develop?
- How will your cash flow develop? When will you expect to break even (= sum of all revenues greater than the sum of all expenses)?
- How high is your need for financing based on your liquidity planning?
- How much cash is needed in the worst case scenario?
- What assumptions underlie your financial planning?
- Which sources of capital are available to you to cover your financing needs?
- What deal are you offering potential investors?
- What return can investors expect?
- How will they realize a profit (exit options)?

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