Chapter 6

BUSINESS MODELS, BUSINESS PLANS

INTRODUCTION

People and institutions will not invest or lend based on the vague promise of some future payoff. They have to believe a company has a well thought out plan. This chapter discusses some of the key elements of a persuasive and useful plan. For example, an investor will want to know why a company wants to raise capital. Some reasons are good, and some are fatal. This chapter will also discuss how to estimate the capital needed so that investors will have confidence a company can achieve its goals without ongoing cash infusions.

Investors will want to know whether the company understands the dynamics of its market and whether it has a strategy for dealing with that market. They will want to know whether the company has a well thought out business model, with reasonable revenue and expense projections as well as a basis for those projections.

This chapter discusses some of the key elements of the marketing plan, detailed cash budgets, contingencies, and other requirements to raise capital, such as the entrepreneur's background and the experience of the company's management team. All of these issues should be addressed before contacting investors or lenders.

WHY IS CAPITAL NEEDED?

The reason a company needs to raise capital is intimately linked to the payoff potential for an investor. Neither banks nor investors want to throw their money into a pit with no clearly identified goal. The pivotal question for the investor is: 'Is my investment going to add enough value to the enterprise so that I can recoup my investment and earn a good return, or is my investment going to be burned up and vanish?'

One of the keys to answering that question is to find out why capital is being raised. Figure 6-1, Reasons for Raising Capital, lists a number of goals a company might want to achieve by raising capital and gives some indication of how those goals might be perceived by investors.

Recall the story of the entrepreneur who wanted to raise $50,000 to pay himself a salary for the year it took him to think up his business concept. Paying the entrepreneur for past efforts will not help the company find its next customer, will not generate a single dollar of new sales, will not advertise the product or lower its manufacturing cost. In short, it would do nothing to grow the company. The chances of raising funds for back pay are zero. A worthy use of proceeds is an integral component of a business plan that an investor will view favorably.

Figure 6-1, Reasons for Raising Capital

Reason	Likely Perception
Cash Flow Break Even	Cash flow break even is the point at which company is generating more cash than it is using. This is a worthy goal because future cash infusions will not be required.
Research & Development	Even if research demonstrates a product is feasible, it is a long way from feasibility to commercialization. Market acceptance must still be demonstrated. This would probably be considered a high risk investment, right for only for investors that specialize in products related to the research.
New Product Introduction	This goal assumes a product has been developed and its market acceptance demonstrated. Bringing a product to market requires cash for pre-sale manufacturing, inventory, sales promotion, and to finance accounts receivable. If the company has successfully introduced other products, this will probably be perceived as a moderate to low risk opportunity.
Fund Plant & Equipment	If a company has an established product line and it seeks funding for more efficient plant and equipment, this would be perceived as a fairly low risk opportunity.