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ENTREPRENEURSHIP

Why Business Plans Don't Deliver

The five most common flaws and how to fix them

By **JOHN W. MULLINS**

An economic downturn is a great time to start a business.

It sounds paradoxical, but think about it. Costs are lower, and more talent is available, thanks to layoffs. Prospective clients are more likely to try a new supplier who can help them cut costs or increase their competitiveness. Established players, too, are focused on cutting costs instead of increasing market share.

The Journal Report

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All of this helps clear the way for the next venture with the better mousetrap but only if the entrepreneur can write a clear and convincing business plan. Anything less is heading straight for the bin. Because, let's face it,

the intended recipients of such business plans investors and lenders, family and friends, anyone with capital to invest in the project are all much more wary of risk now in these turbulent times.

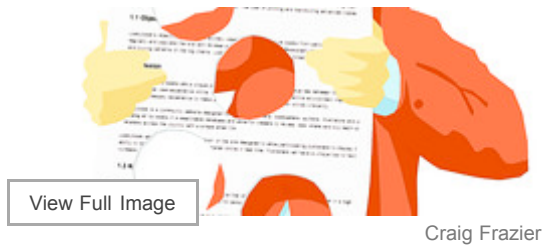
Truth be told, most business plans fail to make much impression on potential investors. Most aren't even read in full. Their shortcomings tend to be obvious even in a two-page executive summary, largely because they are written before enough real work has been done to create a solid foundation.

I set out to understand why most business plans don't deliver. Drawing on the hundreds of plans and pitches that I've seen over many years of working with entrepreneurs and early-stage ventures, I searched for common patterns in plans that gained no traction. The result? Five oh-so-common varieties of plans that go quickly into the trash without further consideration.

To help budding entrepreneurs avoid these traps, I also identified the three key elements that go into a successful business plan: a logical statement of a problem and its solution; a battery of cold, hard evidence; and candor about the risks, gaps and other assumptions that might be proved wrong.



In what follows, I will expose the deal-killers found in the five most commonly rejected types of business plans, and share tips for creating plans that should get you invited back for a second meeting and, if all goes


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Craig Frazier

well, raise some capital and attract some initial customers.

HERE I AM, NEVER MIND THE PROBLEM

In this kind of plan, the writer is smitten with the elegance of his or her technology. The plan begins not with the identification of a customer problem to

resolve, but with a detailed explanation of how the technology works, why it is cutting-edge or state-of-the-art, and how it is better, faster and cheaper than current solutions.

Such a plan is typically readable only by those already in-the-know in its particular technical realm. Even worse, seasoned investors know that the better technology does not always win. Remember Betamax?

A Me-First plan sends a clear signal that the writer's priorities are misplaced. What matters more than great technology or a great idea is the problem or pain that the new solution or technology resolves.

There is a better way. A good business plan starts with a clearly defined problem something that's really troubling or compelling supported by evidence from marketing research, testimonials, letters of intent, or whatever, that the pain is real.

If you can convince your readers that this problem is real, they'll be hooked, at least for a while, as they read on to see whether you've found a solution that can resolve the pain. If the pain isn't real, stop writing. There's no need for a solution.

Next, identify exactly which customer group has that pain, even if the initial target market is a small one. Investors know that, if a sustainable beachhead can be established in an initial target market, success in a niche market can serve as a platform for taking the solution to other market segments as the business grows.



Consider Nike Inc., the leading maker of athletic footwear. Founders Phil Knight and Bill Bowerman, a distance runner and a track coach, respectively, addressed the quite literal pain of distance runners' sprained ankles, shin splints and other injuries caused by the miles and miles of training on rough country paths in running shoes that just weren't up to the task.

The new waffle soles of latex rubber that Nike came up with addressed runners' pains head-on. The first shoes targeted elite distance runners, hardly a large market.

But once distance runners started winning Olympic medals wearing Nike shoes, other runners and sports followed.

A COKE FOR EVERY KID IN CHINA

This gambit rests its case on a plethora of secondary data to show how large and fast-growing a market is. The plan then makes a heroic leap and assumes that the new venture will grab X percent of that market it could be 1%, 10%, 30% or whatever. "Surely," the plan argues, "with the large number of

customers in our market, we'll easily get enough. We only need a small fraction to have a very nice business."

Plans like this reveal that the writer isn't sure what the initial target market is. It's much easier to win a large share of a carefully targeted but narrow market than it is to win a small share of a very large market.

Further, penetrating a new market requires customers who are aware of the new product, and distribution systems that allow them to buy it. Coke-for-Every-Kid plans gloss over these details. They ignore the difficult work not to mention the expense of crafting a strategy to gain market awareness, persuade customers, and set up distribution.

This kind of plan also often signals that the writer is reluctant to get out from behind his or her Internet connection and actually talk to prospective customers. Talking to customers is harder work, but brings all kinds of benefits and insights, not only to the business plan, but also to the business itself. Such conversations can reveal what customers really want and help tailor the offering to meet those needs.

You can probably find secondary data that support such things as the size of your market and trends that suggest your market will or won't grow. All such evidence should be cited, with its source, to show that the data are reliable and credible, and that you are, too. But that's just the start. You'll need primary data, too, from interviews you carry out or a survey you conduct, to demonstrate the likelihood that customers will buy what you have to offer.

Conduct some experiments, even a market test. The more hypotheses you can test before writing your business plan, the more convincing you'll be. One caveat, though: If you wait for all of the evidence before you get started analysis paralysis the opportunity may well be lost, as someone else may beat you to market.

Every assertion in your plan should be backed up by evidence. If it's not, take it out, or stop writing while you gather the evidence you need.

JUST LOOK AT OUR (PAPER) PROFITS

Of our five fundamentally flawed business plans, this one is perhaps the most difficult to spot.

The archetype is the failed Internet business Pets.com, which offered pet supplies via the Internet. Simply put, the economics of delivering large, heavy bags of dog food one at a time could not compete with the economics of putting pallet-loads of the same bags of dog food on supermarket or discount-store shelves and

letting the customers do the delivery.

Such business plans often contain detailed spreadsheets showing why the numbers would work. That's why these kinds of plans are difficult to spot: the numbers look like they work. As one entrepreneur told me, "With a couple of beers and an Excel spreadsheet, you can make a lot of money in no time," or so it will seem. While consumers certainly liked the idea of having Fido's dog food delivered, they were not prepared to pay a price that would enable the economics to work.

Savvy investors not only tear apart the spreadsheets but ask fundamental questions. Does the revenue

model depend on making a large number of small transactions (think [Amazon.com](#)) or a small number of large ones (automobile manufacturing)? Do its profit margins depend on high gross margins to cover high product-development costs (think [Microsoft](#)), or lower margins to cover slimmer operating costs ([Costco](#))? Is a large investment in development or other fixed assets required (a manufacturing facility, for example)? Is the working capital cycle favorable or unfavorable (do you expect to be paid in advance), or will you have to carry inventory and receivables that can tie up scarce cash (manufacturing and distribution businesses)? Some combinations of these factors are clearly attractive. Others are obviously flawed from the start.

OUR TEAM WALKS ON WATER

Investors won't be snowed by top-tier diplomas or past employment with a leading company. Investors care first about the main challenges of the industry in question, and whether the proposed team has hands-on experience tackling those challenges.

Every industry has critical success factors typically two or three that, when addressed effectively, are likely to bring success even if less-important challenges aren't handled well. Location, for instance, is a critical success factor in much of retailing.

A business plan that identifies its critical success factors and shows how the team's expertise and experience are suited to addressing them is much more likely to attract capital or at least a second look.

Here's where candor helps, as well.

Surprisingly, plans that point out the lack of a key skill or capability in the management team can fare quite well, by acknowledging the missing link and encouraging the prospective investor to fill that slot with a qualified person whom he or she favors.

Plans that succeed in attracting capital often include one or more members of a team who have failed in a prior venture. When that failure is accompanied by lessons learned, it's often viewed, as one investor told me, as "an education on someone else's nickel."

For Further Reading

See these related articles from MIT Sloan Management Review

Closing the Gap Between Strategy and Execution

Donald N. Sull (Summer 2007)

In fast-paced industries, companies should think of strategy as an iterative loop with four steps: making sense of a situation, making choices, making things happen and making revisions.

<http://sloanreview.mit.edu/x/48412>

Should You Build Strategy Like You Build Software?

Keith R. McFarland (Spring 2008)

The strategic planning model is due for a "new release," one that enables companies to keep pace with changing environments, quickly create and adapt strategy, and empower people throughout the organization to make effective choices.

<http://sloanreview.mit.edu/x/49315>

EVERYTHING IS WONDERFUL

The most common type of business plan, and the one that goes most quickly into the trash, is the one in which the writer can't find anything but good things to say about the opportunity and plans to pursue it.

Investors know that in the real world most opportunities, even good ones, have some weaknesses. Typically, it's not yet clear in an early-stage business whether the customers will buy, or buy at the price that's been proposed. Most industries are not filled with infinite possibilities, either, especially given the overcapacity in today's global economy.

Experienced entrepreneurs know better than to assert that everything is wonderful about their opportunity. They know there are potential pitfalls in their market or industry.

A New Strategy Framework for Coping With Turbulence

Bala Chakravarthy (Winter 1997)

In turbulent environments, market leaders must repeat innovations, establish customer networks, sense the flow of new products, and share responsibility for new strategy throughout the company.

<http://sloanreview.mit.edu/x/3825>

The facts are that most opportunities are highly uncertain. Most new ventures will fail. Of the few that do succeed winning capital, customers and positive cash flow it's usually not because of the original plan, "Plan A," about which the business plan is written, but because of an as-yet-unknown "Plan B."

Candor, again, is key. There probably will be some questions implicit in your business plan that have not been answered. Will your solution actually work? Will customers buy it? How much will they pay? How will competitors react to your entry? Does your entrepreneurial team have what it takes the experience and expertise to deliver on the critical success factors that apply in your industry?

Rather than attempt to paper over the rough spots and uncertainty, identify them yourself and deal with them candidly in your plan. A solid dose of candor will go a long way, compared with describing risks and then stating why they won't occur.

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Telltale Terms

Many business plans fail to deliver because they cloud the opportunity in a fog of terms that make investors wince. Here are some words and phrases to avoid.

■ **Huge** (as in "Our market is huge!")
Translation: The writer hasn't bothered to get reliable data on market size, or has failed to think carefully about the initial target market, which almost always should be quite narrow. Nike's initial target market of elite distance runners was minuscule, but it provided a solid foundation for growth.

■ **Conservative** (as in "We conservatively forecast that...")
Investors know that the initial sales numbers—never mind the profits—rarely pan out. So, let the numbers speak for themselves, based on the evidence you've gathered.

■ **Revolutionary** (as in "Our revolutionary technology...")
Translation: "We are so enamored with our idea that we have not thought clearly about how to distinguish it from other approaches and are not interested in what the customer thinks of it. Customers simply aren't visionary enough to fully appreciate our technology..."

■ **Assumptions** (as in "Assumptions for the figures in our financial statements")

If you are "assuming" most of your numbers, you'd better stop now. A far better notion is "Evidence that underlies each of the figures," set forth in a table in front of the financial section so the figures can be readily used to stress-test the plan in advance as well as to update the plan as further evidence becomes available.

■ **We believe** (as in "We believe that...")
Translation: "We haven't bothered to obtain a shred of real evidence, because we've been too busy writing this business plan to actually gather any evidence, but it is our desperate hope that..." If you don't have any evidence, stop writing and go get it!

■ **No competition** (as in "We have no competition.")
If there's a single phrase that can send a business plan directly into the trash, this is it. Of course you have competition! They just haven't heard of you yet. To prospective investors, perhaps surprisingly, competition may be a good sign, as it suggests that there's a problem that someone besides you thinks is worth solving.

Source: John W. Mullins

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