

Chapter 4 The Business Plan

Chapter 4: Business Plan

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INTRODUCTION

The Business Plan is the fundamental road map for any new business. This chapter presents the remaining topics to be included in your final Business Plan and provides a structure for presenting the material in a coherent form to potential lenders, investors and partners.

To reiterate, a good Business Plan does the following:

- Shows that the proposed business is a serious initiative, undertaken by capable entrepreneurs who understand and have control of the essential elements that will ensure success.
- Increases the chances that an entrepreneur will be able to attract investors, lenders, partners, strategic allies, suppliers and key staff.
- Forces the entrepreneur to collect, in one place, all of the thinking and research that has gone into the development of a proposed business.

LENDER AND INVESTOR POINTS OF VIEWS

It is important to differentiate between lenders and investors.



Lenders (usually bankers) make loans (debt) with the expectation of receiving a very specific set of payments over time. Their requirements are usually well defined in terms of conditions that must be met in advance and over the course of the loan. *Lenders do not want to take risks* and they do not generally enjoy any benefits of a business being profitable. Lenders want to be repaid and, if the business cannot make that repayment, they want to know that others will make the payment or that assets of equivalent value are available to reimburse them.

Investors make equity investments in businesses. They expect a higher return than lenders and are willing to take more risk, but this should not be confused with being risk-takers. They are equally clear about what they are willing to do or not do. Their interests are in seeing a business succeed and in earning a return on their investment. If they become significant participants in a business, they tend to establish very specific (and stringent) targets to make sure that things are going well. When things are not going well, investors often have the ability to make significant changes in a business, including replacement of the management team.

It may sound as though the interests of lenders and investors are the same: to get paid. Sometimes this is true, especially when things are going well and especially in the early stages of a business. However, very few businesses

go exactly as planned and 'course corrections' are needed. Depending on the degree of correction, the interests of lenders and investors may become very different.

Why do Investors Invest? Investors provide equity to a business for a variety of reasons. It is important that entrepreneurs understand the goals and objectives of investors before going too far in discussions. Investors provide equity to:

- Produce income in the form of cash dividends (often in a particular pattern as in the case of an investment fund that has promised returns to its investors over a specific time period).
- Achieve capital growth (with or without specific time constraints; a traditional equity investor-partner is involved over the life of a business whereas a fund investor, as noted above may have a contractual obligation to liquidate its investment in 6, 8 or 10 years).
- Enter a market (and thereby avoid the start-up and market research costs and problems of entering a market alone, preferring instead to join forces with a business already developed).
- Sell a product (especially equipment).
- Form a partnership and thereby grow quickly (similar in appearance but substantively different from making an investment to enter a market).

In contrast, why do lenders make loans? The list of reasons tends to be shorter, but it is equally important, especially in a new field such as renewable energy, to understand the motives of a lender. Taking it for granted that all lenders make loans because that is an important part of their business and a source of profits, there are other reasons to consider. Lenders make loans (provide debt) to:

- Build relationships with clients who will be a source of future business.
- Enter new business areas that can expand their loan portfolio profitably and provide a competitive advantage to the bank.
- Contribute to economic and social growth and thereby stimulate greater lending activity.

It is important to note that many banks simply do not lend for 'projects' (bankers separate project finance-which includes loans secured by the infrastructure project itself-from corporate finance-in which the activities and assets of a company guarantee a loan-and many do not lend to groups without substantial experience and assets). Being aware of the interests of banks in advance can save a great deal of time.

What do lenders and investors look for? There are different degrees of emphasis placed on the following factors, but both lenders and investors look for:

- Strong sponsor (experience, credibility, skills, commitment of time and money).
- Solid business fundamentals and assumptions (raw materials, process, outputs).
- Clear competitive advantage and business strategy.
- Risk assumption by others (completion of business both from the standpoint of time and money, insurance for accidents, guarantees of performance of equipment).
- Clear legal and regulatory framework (energy sector, banking and investment sectors, tariffs, taxes, and incentives).
- Country stability (political, economic and disasters, especially climate driven).
- Exit mechanisms (for bankers: repayment backed up by security and guarantees; for investors: sale of assets or shares to third parties, buy-back by business, re-financing, dividends).

FINANCIAL PLANNING

In Chapter 3 you took the first step in preparing the Financial Statements to be included in your Business Plan-the Income Statement and Pro-forma Income Statement. Now it is time to prepare the Balance Sheet and Cash Flow Statement, the two remaining elements of your financial analysis.

Balance Sheet

The balance sheet is a financial presentation of what your business owns and what it owes at a specific date. It differs from the Income Statement in that it is like a snapshot of your assets and debts at a given point in time, whereas the Income Statement measures the flow of money in and out of your company over a given period.

Anything that your business owns is an Asset and anything your business owes is a Liability. The Balance Sheet traditionally splits a page into two columns, one for Assets and one for Liabilities. Broadly speaking, assets are anything

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that will create future financial benefits for the company.

The company's assets are presented in order of **liquidity**, which is defined as the ease by which the asset can be converted into cash without a loss in value. For example, cash your company has in the bank would be listed before a building your company owns, because cash is a liquid asset and real estate is not. More generally, assets are divided into three categories:

Current Assets: includes any items that can be converted easily into cash over the next 12 months. Examples include cash, inventory, short-term investments and accounts receivable (which is the amount of money you are owed by customers, partners, etc., but that has not yet been paid).

Non-Current Assets any items that cannot be easily converted into cash within 12 months. May include land, buildings, equipment, furniture, and vehicles. Non-Current Assets are also referred to as Fixed Assets.

Long-term Investments: any commitments the company has made in terms of long-term investments. For example, if you own equity in another company, or if your company has made a loan to another company, that would be listed here as an asset.

Total Assets: The total of your company's Current and Fixed Assets.

Liabilities are promises or commitments by your business to pay some amount at some future date. Similar to the Assets section, the Liabilities section of the Balance Sheet is presented in the order in which the liabilities come due. It includes:

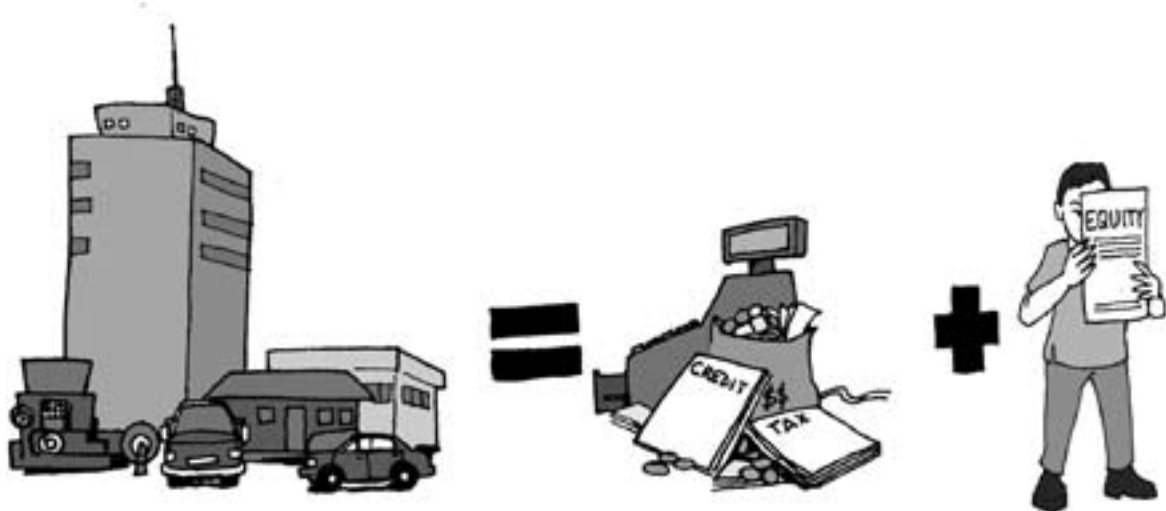
Current Liabilities: debts and monetary commitments payable within the next 12 months. This includes accounts payable (money you owe to suppliers and employees), short-term debt, interest and taxes.

Non-Current Liabilities: debts and monetary commitments payable over a period longer than 12 months, including taxes.

The Liabilities column also has a section called Owners' Equity. The Owners' Equity section keeps track of how much money the founders have contributed to the business, and also keeps track of how much money the company has earned and then put back into the business. Money invested by the founders is called 'Contributed Capital,' and money generated by the business and reinvested in the company is called 'Retained Earnings.'

Owners' Equity: this is the owners' investment in the company. Break into separate lines if there are multiple owners or shareholders. Also include a line for Retained Earnings if necessary.

It is imperative that *your company's Total Assets equal your Total Liabilities plus Owners' Equity*. This is commonly known as the Balance Sheet Equation.



Although it might sound complicated, it's actually quite simple. For example, if you invest US\$1000 in your company, the value for Contributed Capital in the Owners' Equity section will be US\$1000, but, on the Asset side, the value for cash will also be US\$1000. Thus the equation holds, and the balance sheet 'balances'. In another example, if you take out a loan to buy equipment, the Liabilities side will show the value of the loan and the Assets side will show the value of the equipment. Again, the balance sheet balances.

An example of a balance sheet is given below.

Company Name Balance Sheet DATE			
Assets		Liabilities	
Current Assets	Value (\$)	Current Liabilities	Value (\$)
Cash		Accounts Payable	
Accounts Receivable		Short-term Debt	
Inventory		Interest Payable	
Short-term Investments			
Other		Other	
Total Current Assets		Total Current Liabilities	
Non-Current Assets		Non-Current Liabilities	
Building		Long-term debt	
Equipment		Taxes Payable	
Land		Other	
Long-term Investments			
Other			
Total Assets (Current + Non Current)		Total Liabilities (Current + Non Current)	
		Equity	
		Contributed Capital	
		Retained Earnings	
<i>Total Assets</i>		<i>Total Liabilities + Owners' Equity</i>	

Cash Flow Statement

You now have all the information needed to prepare a Cash Flow Statement, which is basically designed to explain the change in your company's cash amount during a given period. In some ways, the Cash Flow Statement is similar to the Income Statement-both measure flows of money over time. But the Cash Flow Statement specifically deals only with cash transactions the company has completed. Money that the company owes but has not yet paid will not appear on the Cash Flow Statement, but will often appear on the Income Statement.

It is recommended that you prepare two Cash Flow Statements. The first should be monthly and should cover a year of operations. A monthly Cash Flow Statement illustrates when you generate revenue and whether or not you can pay your expenses each month. The second Cash Flow Statement should be annual and cover a five-year period or a period long enough to show that assets are used or that loans are paid. An annual Cash Flow Statement shows that you can pay your debts and gives a lender or investor an idea of how your business grows and what return they can expect for their money.

The easiest way to compile your first Cash Flow Statement is to look at your Income Statement and start with your Net Profit (or loss). Then:

Add back Depreciation: For the Income Statement, you deducted Depreciation but it was not a cash expense, so it must be added back to calculate your cash flow.

Add back Debt Payments: Deduct payments on loans because they were cash outlays.

Net Cash Flow: The total of Net Profit plus Depreciation and minus Debt Payments.

Internal Rate of Return: This calculation measures the extent to which investors earn money for their initial investment. The simplest way to calculate this is using Microsoft Excel or other software. The concept is explained in more detail below.

Example of a Cash Flow Statement:
Company Name
Statement of Cash Flows
From DATE to DATE

Cash Flow	Amount
Net Profit/Loss (From Income Statement)	
Add back Depreciation Expense (From Income Statement)	
Subtract all Debt Payments	
Net Cash Flow	
Internal Rate of Return	See below

Internal Rate of Return

The point of completing a Cash Flow Statement is that it helps you determine your company's Internal Rate of Return (IRR). IRR measures how much financial return you make on your company's investments. IRR is a critical number, because if your company's IRR is less than the interest rate it pays for loans, clearly the business will not be able to pay its debt. If your IRR is higher than the interest rate you pay on loans, that's very good.

Based on cash flow projections it is relatively easy-with the aid of a financial calculator or spreadsheet software-to determine the business's IRR. **See Annex E** for a guide.

Combined with a few pieces of additional information it will be possible to decide whether or not a business is generally sustainable from a financial perspective.

Once you know the business's IRR, answer the following questions:

- * What is the current interest rate charged for loans in the local market?
- * What is the current or projected interest rate for loans from outside the current market?
- * What are investors demanding as a rate of return to make their funds available to business as equity?

If a business's IRR is 16 per cent and the cost of borrowing money in the local market is 20 per cent then there is little reason to borrow in the local market unless a large portion of the business capital will come from the entrepreneur or others who are willing to receive a low rate of return.

There are cases where lower-interest loans are available. Generally, concessionary finance programmes by governments or institutions offer loans at 'below-market' interest rates. Also, companies sometimes offer low-interest financing on the sale of their equipment or services. Such financing can serve to lower your company's 'hurdle rate,' which is the IRR a business needs to meet to be feasible.

When is a business not feasible from a financial perspective?

- * If a business has a negative IRR.
- * If a business's IRR is too low for even the entrepreneur to invest his or her available cash.

* Assuming the entrepreneur does not have all the capital required, if the business IRR is too low to attract other equity investors to supply cash.

You should read **Annex E-Basic Concepts of Financial Analysis** for a review of the terminology and methods presented here.



The Hardest Task

This is the stage of analysis where many well-intentioned entrepreneurs refuse to see the reality staring at them from the numbers they have prepared. If your IRR is too low, the business idea, as it stands, is probably not viable. There is hope in ‘financial engineering’, higher revenues than estimated, lower costs, eliminated contingencies, subsidy programmes, lower loan costs, value increases and so on. It is OK (and normal) to refine estimates, but there is a point at which only the entrepreneur can determine if he or she is deluding himself or herself. It is easy to change assumptions and improve the IRR. There is an old saying that statistics do not lie; only statisticians do. Notwithstanding the ability to manipulate data-and with the help of spreadsheets it is as easy as ‘point and click’-the entrepreneur needs to decide if refining the estimates and financial plan really makes sense.

At this point in the business analysis *there should be a great deal of room for error*. If the business is just barely financially feasible, if the business absolutely depends on convincing others to make loans and equity investments, if the business estimates have been gone over and over mostly to make the result better, if the entrepreneur has sought the opinion of others and it is still a very close call, then **continuing with the business is probably a bad use of the most valuable commodity an entrepreneur has: his or her time.**

SCHEDULE OF ACTIVITIES

If you’ve made it this far, the rest of the Business Plan is easy. Now it’s time to put together a schedule, or timeline, of when you will implement the business strategies. The key milestones, such as hiring employees, receiving approvals for permits, acquiring stock, expansion activities and reaching profitability should be included here. Again, be thorough but keep it clear and simple.

A schedule helps you and your audience to understand how the business is planning to accomplish the goals and deliverables presented throughout the document. It shows that you have thought through the implementation, that you are organized and that you understand how to launch operations. A simple approach is to divide the schedule into the following categories: Planning, Pre-operations/Construction and Operations.

Start a draft timeline using the following table. Include a description of each activity under each category. Estimate a date when the activity will be pursued.

Category	Activity	Timeline
Planning		
Pre-Operations/ Construction		
Operations		
Expansion		

RISKS AND MITIGATION MEASURES

Every business, start-up or expansion has risks. This section of the Business Plan should present the risks and appropriate mitigation measures. A mitigation measure is a strategy for how your business will address a risk. Not every risk can be avoided and it is important to demonstrate that you are aware of this and have thought of how you will attempt to protect your business. *There is no benefit in hiding risks, as lenders and investors will do their own research, called ‘due diligence’, and uncover them anyway.* By not including them the investor may think the risks have not been considered, which may make the entrepreneur seem less knowledgeable. Types of risks facing an energy business are given below. For a more detailed analysis, see **Annex F-Final Risk Checklist.**



- Country: Does the country have a history of political stability?
- Are regulations transparent and enforceable?
 - Management Team: Does the management team have adequate experience in the proposed line of business?
 - Operations: Is the depth of the operating team sufficient to support the financial assumptions?
 - Construction Completion: If construction time overruns the completion date, what are the legal implications outlined in the contracts?
 - Technology: Is the technology proven?
 - Competition: How will the business compete against another business selling the same product in the same region?
 - Suppliers: If the supplier falls through, how many back ups are there?

IMPACTS

For energy businesses, this section of the Business Plan should highlight the positive impacts of the business. Many lenders and investors are looking to invest in businesses that are very profitable. Others, however, are looking for profitable businesses that benefit the environment or community. For example, delivering energy services to households which lack reliable access to such services may improve their quality of life. Improved cook stoves are more efficient than traditional metal stoves and use less charcoal or wood, thus helping to conserving these non-renewable resources. *There are lenders or investors that will support businesses that have positive impacts*, so it is advisable to highlight those impacts in your Business Plan. They can be competitive advantages for your company as you seek funding.



The impacts of the business should be analysed from a social, environmental and economic perspective. Social impacts affect the customers or people of a community or region. Examples can be income generation, reduced time fetching water or wood, access to education or reading, etc. Economic impacts are a result of an increase in income to the customers or community. An example is selling a lantern or solar home system to shop owners so that they can stay open in the evening and thus increase their sales. Finally, positive environmental impacts are those that preserve the environment. All renewable energy businesses have environmental benefits because the technology used is environmentally-friendly relative to traditional energy operations. Projects and services that offset or reduce dependence on wood or charcoal preserve forests and combat desertification, providing an important positive environmental impact.

It is not necessary for every business to have each of these three impacts. However, any positive social, environmental or economic impacts should be clearly expressed in the Business Plan as they are an asset.

SUMMARY OF WHAT HAS BEEN LEARNED

The aim of this Toolkit has been to break the Business Plan into building blocks to make the task of writing it less daunting. This chapter has introduced the final necessary elements of the Business Plan and all sections of the Business Plan and their contents have been covered. It is now time to compile all your written material into the Business Plan. The final step is to review the outline of the Business Plan format below, and compile your information into a descriptive, organized document that can be presented to possible lenders, investors or partners. **Annexes G, H, I and J** provide helpful examples and information to assist you in this final stage.

DETAILED OUTLINE OF AN ENERGY BUSINESS PLAN

A good Business Plan is built on solid information. That information can be organized in many different ways but the essential ingredients remain the same. These are listed and then described in more detail below. While certain businesses may require additional content, most business information can fit within this structure.

- COVER and TABLE OF CONTENTS
- EXECUTIVE SUMMARY
- BUSINESS DESCRIPTION
- OPPORTUNITY
- MARKETING
- COMPETITION
- OPERATIONS
- TECHNOLOGY
- FINANCE
- SCHEDULE
- RISKS
- IMPACTS
- CLOSING, which describes the business's proposed capitalization plan and what is being requested from lenders and investors
- A set of ATTACHMENTS, which provide details concerning some of the points made in the Business Plan

Cover and Table of Contents

- Business Title, Location, Technology, Size
- Contact Information
- Contents by Section and Page Number
- Disclaimer and Confidentiality Statement

Executive Summary

This tells the business's story in one page, providing a brief introduction of what's to come. It should present the most compelling aspects of your company and make potential investors want to learn more.

Section 1-Business Description

In this section of the Business Plan the product or service to be sold is described as well as the location. The goals for starting the business are presented. Finally, the business structure-retail, wholesale, manufacturing, project development-should be explained, as well as the ownership structure. How are profits to be distributed? Any permits or licenses that have or need to be acquired should also be presented. The section need not be long or detailed, concentrate rather on making it clear and concise. The Business Description completed in the Feasibility Analysis can be used in the Business Plan.

- Business location and Setting
- Product or service to be offered
- Goals and Objectives
- Business legal and ownership structure
- Permits and licenses

Section 2-Opportunity

Describe the customers that will buy your product or service and explain why they will do so. The goal of this section is to prove that there are sufficient customers that are willing and able to buy your product.

Section 3-Marketing

This section gives a detailed presentation of the strategy for selling the product or service. It should have been completed in Chapter 3 and presented in the Feasibility Analysis. Include the following:

- Pricing Strategy
- Distribution Plan
- Advertising and Promotion

Section 4-Competition

This section provides the opportunity to explain why there is and will continue to be demand for your product or ser-

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vice in light of the competitors. It is also extremely important for you to understand your competition and it helps you learn about the market. Use the section created for the Feasibility Analysis, including the following:

- Names and description of competitors
- Strengths and weaknesses
- Competitive advantage

Section 5-Operations

This section describes how the business will operate. It describes your organizational structure and then how each department will operate. Again use the completed section from the Feasibility Analysis.

- Organization Structure
- Operations

Section 6 -Technology

This section describes in detail the technology and energy resource to be used. Explain the process, appropriateness and track record. Use section completed in Feasibility Analysis.

Section 7-Finance

In this section all of the financial features of the business are presented. The most important financial assumptions of the business are shown, the proposed financial plan is described and an analysis is made of the impact of various changes to the basic financial assumptions.

- Worksheet of funds required
- Income Statement
- Balance Sheet
- Cash Flow Statement

Section 8-Schedule

Present a schedule and timeline of major milestones to be reached.

Section 9-Risk Factors

This section describes the risks that the business faces and how the business plans to deal with these risks. Include the risks with possible mitigation measures.

Section 10-Impacts

Social, economic and environmental benefits of the business's implementation, and any other special features of the business, are described in this section.

- Local employment
- Economic activity stimulated
- Improvements to physical assets
- Social benefits
- Protection of environmental quality
- Pollution avoidance or elimination
- Greenhouse gas (carbon) benefits

Closing

The Closing section of the Business Plan summarizes the business's proposed capitalization plan and what is being requested from lenders and investors.

Attachments

- Complete financial statements
- Summary of technical and market studies
- Copies of authorization letters and permit approvals
- Detailed background and financial information about the sponsor

Annex G includes sample Business Plans for a:

- Grid-connected hydroelectric business;
- Solar enterprise selling both product and services to rural communities; and,
- Company providing income generating equipment dependent on energy supplies and efficiency.

You are done with the Business plan.

Congratulations and Good Luck!

