

**GOALS**

Explain the purpose of writing a good business plan

Describe the importance of a business plan

**KEY TERM**

business plan, p. 34

**JUMP START**

Nora Ellis and Samantha Richards are qualified childcare workers who have worked together at a day-care center for many years. The center frequently turned away children because it did not have the room or the staff to take care of more toddlers. Nora and Samantha realized they could make a profit running their own day-care center and decided to open a center of their own. Everyone they talked to about their idea said it sounded good and wanted to see their business plan. They realized the need for a good business plan to help ensure their business would succeed. Why do you think a business plan is important for someone starting a business?



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## Purpose of a Business Plan

Once you have worked out the details of your business, you need to put everything down on paper. Writing out these details will help you visualize all the aspects of your business. It will also help you convince banks and other people to invest in your business idea. A **business plan** is a written document that describes all the steps necessary to open and operate a successful business. Writing a business plan is one of the most difficult and important things you will do as an entrepreneur. Writing a solid business plan is critical because the plan can make or break your business.

The business plan

- Describes what your business will produce, how you will produce it, and who will buy your product or service



- Explains who will run your business and who will supply it with goods
- States how your business will win over customers from competitors and what your business will do to keep customers
- Provides detailed financial information that shows how your business will succeed in earning a profit

The business plan serves three important purposes.

1. **A business plan explains the idea behind your business and spells out how your product or service will be produced or sold.** To convince investors that your business idea is solid, you will need a completely new product or service or one that is better or less expensive than products or services that already exist. You will need to identify who your target customer is and show how your company will be able to obtain and keep customers.
2. **A business plan sets specific objectives and describes how your business expects to achieve them.** A good business plan includes sales projections for the short term (the first year), the medium term (two to five years after startup), and the long term (five years in the future). It describes what products and services will be introduced over the next five years and sets forth future business plans, such as expansion of the business.
3. **A business plan describes the backgrounds and experience of the people who will be running the business.** Banks and other lenders make financing decisions based on how well they think a company can meet its objectives. If you provide information on the background and experience of the people who will be running your company, the bank or investor will be more likely to invest money in your business.



Creatas/Jupiter Images

## TEAMWORK

In small groups, brainstorm the ideal backgrounds and experiences of people who could run these new businesses: roofing company, software development group, convenience store, accounting firm.

Why is a business plan important to the success of the business?

## CheckPOINT

What are the three main purposes of a business plan?

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## Importance of a Business Plan

Every new business must have a business plan. When comparing businesses that succeed to those that fail, there is often one important difference—the business plan. Business owners that develop and follow a business plan are more likely to succeed than business owners who do not have a business plan. The business plan is important for several reasons.

1. **A business plan makes you think about all aspects of your business.** Stan Meyer began a graphic design business from his home. He spent many hours visualizing the business and thought he was ready to start it until

he sat down to write his business plan. He had not made sales and profit projections. He had also not thought about the possibility of needing to hire staff if the business grew too large for him to handle alone. Drafting a business plan helped Stan gain even more confidence in his business idea. It showed him that building a successful business based on his concept would be possible. Working on his business plan also helped Stan think through business strategies, recognize limits, and identify problems he might encounter.

2. **A business plan may help you secure financing for your business.** Lenders require a business plan before they will consider financing a business. Without a business plan

you will not be able to obtain a business loan. Lenders will review the financial section of the business plan, which will state how much money is needed to operate the business and how the money will be used. Lenders will also be interested in the financial projections showing estimated revenue, expenses, and profit.

3. **A business plan helps you communicate your ideas to others.** By the time you write your business plan, you will have given much thought to the business that you want to establish. You will also believe that your business will succeed. If you communicate your ideas well on paper, you will convince the reader that your business will succeed. This can help you get a loan from a bank. It also may convince suppliers to extend credit to your business.

### NETBookmark

The textbook lists several reasons why business plans are important to entrepreneurs. Access [www.cengage.com/school/business/21biz](http://www.cengage.com/school/business/21biz) and click on the link for Chapter 2. Read about Barbara Mulford's experiences starting her own business. Why did she originally write her business plan? Identify at least one way her business plan was important to her becoming a business owner.

[www.cengage.com/school/business/21biz](http://www.cengage.com/school/business/21biz)





## Business Math Connection

When making decisions about loans, loan officers look at industry information, location, marketing plans, and your qualifications and experience. They want to be sure that you and your business are good risks and that you will be able to repay the money they loan you. The amount of the monthly payment will be calculated, and the bank will determine if you can meet the repayment plan. If Nora and Samantha need a bank loan of \$55,000 and the bank offers them a five-year loan at an interest rate of 8 percent per year, what is their monthly payment?

### SOLUTION

To calculate interest, use the following formula.

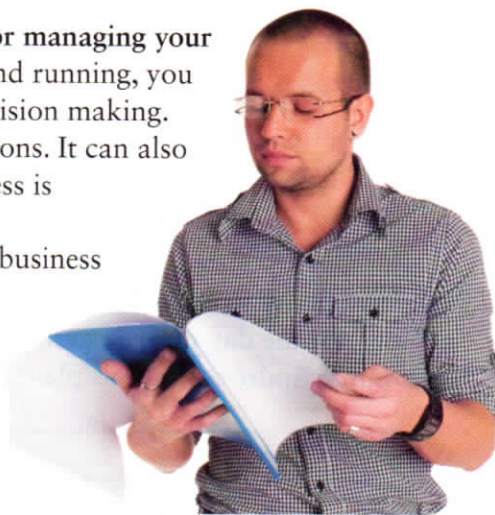
$$\begin{aligned} \text{Interest} &= \text{Principal} \times \text{Rate} \times \text{Time} \\ \text{Interest} &= \$55,000 \times 0.08 \times 5 = \$22,000 \end{aligned}$$

To calculate the monthly payment, use the following formula.

$$\begin{aligned} (\text{Principal} + \text{Interest}) \div \text{Total Number of Payments} &= \text{Monthly Payment} \\ (\$55,000 + \$22,000) \div 60 \text{ months} &= \$1,283.33 \end{aligned}$$

4. A business plan can serve as a tool for managing your business. Once your business is up and running, you can use the business plan in your decision making. It acts as a guide for business operations. It can also be used to track whether your business is developing according to plan.

Adam Rothwell regularly uses his business plan to help manage his company, Suburban Pools. Adam's plan laid out his vision of how the company would grow over time. By following the strategies he described in his plan, he has increased sales by offering new products and by targeting a larger area.



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How can a business plan be used to manage a business?

### CheckPOINT

Why is a business plan important to an entrepreneur?

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