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The Business Plan from a Lender or Investor Perspective

In our last newsletter, we talked about how a business plan can be a driver of success for an enterprise. If a company has a clear and distinct strategic plan that ties into their business plan and the management and employees are engaged in the process and have bought into the plan and its expected results, the chances for success improve dramatically.

But in many instances, the purpose of the business plan is to also attract financing, be it in the form of debt or equity. In this newsletter, we will be discussing the business plan from a lender or equity investor perspective.

What does a lender look for in a business plan in order to make the decision to loan to a company?

1. All of the elements listed in our last newsletter and repeated above. A business plan put together on an ad hoc basis will not be as successful in attracting financing as one put together as part of an effective, annual planning process.

2. A business model that is plausible and profitable. If the model is broken, management should outline the steps they plan to take in order to fix it. Ideally some of these steps will already have been taken when the plan is presented to lenders so that the benefits can be seen in the current financial results.

3. An industry that shows growth or the potential for growth. If the industry is stagnant or shrinking, the market should have barriers to entry or the company should have an inherent competitive advantage to avoid potential competitors from entering the marketplace.

4. Financial forecasts that tie into all of the items listed above. Besides having a balance sheet, income statement and cash flow for a forecast period of three to five years, the forecasts should also incorporate the following:

    a. Assumptions regarding any sales forecast increases;
    b. For those companies in the midst of a turnaround, overhead savings as a result of a well-defined restructuring plan; and
    c. Improvements in gross margin as a result of management initiatives to improve this important financial metric.

Any discussions on the use of proceeds should be consistent with the cash flow incorporated in the forecasts.

It is important to note that some lenders will not lend to companies unless certain financial covenants or hurdle rates are met. Management should ensure that these targets are met in the forecasts prior to submitting a plan to one of these lenders.

A key component in any lender's decision to lend to a company is the track record and credibility of the management team currently in place. Management should avoid using assumptions in their forecasts that result in "hockey stick" results i.e. forecasts that show losses in the current year and significant profits in subsequent years without plausible assumptions attached to the improvement in results. Similarly if the company is in the midst of a turnaround and there's been no change in the makeup of the management team, then the lender will probably question the credibility of the plan since the authors of the plan were those responsible for the company getting into financial difficulty in the first place! The obvious question they will ask is "What's changed to make us believe that you can turn this around?"

An equity investor's requirements from a business plan are quite similar to those of a lender's. The main difference relates to the exit strategy. Loan agreements usually expire after a specified period of anywhere from one to five years. An investor (in theory) is in it for the long haul. A savvy investor however, will not invest in a company unless it sees a viable exit strategy within its investment time frame. For example, a private equity firm may have an internal guideline that requires it to invest in companies for no longer than five to seven years before having to sell and redeploy the proceeds elsewhere. If this firm doesn't believe it can sell its position in a company within this time frame (and at a significant rate of return), it will not make the investment.

Most importantly, management must put themselves in the shoes of a lender or investor and ask the question: "Should I loan or invest money in this company?" If the business plan doesn't facilitate an answer in the affirmative, the company will not be successful in attracting the required financing.

Aries Advisory Group Ltd. has significant experience in the preparation of company business plans for financing purposes. We also have numerous contacts in the financing community and can facilitate a financing process with a qualified lender or investor, ensuring that your plan meets their lending or investment criteria. Significant time will be saved by avoiding those parties whose criteria you won't meet. If you have a financing and/or business plan requirement, please contact us at info@ariesag.com or at (416) 467-7878 to see how we can help.