



Fatal Business Planning Assumptions

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What is a disaster? The dictionary says it's "an event resulting in great loss and misfortune." For business owners, the translation is "an event that affects the ability of a company to survive."

If you are developing plans for a new venture, then you are making assumptions about how your venture will operate because you do not yet have absolutely accurate information. Your assumptions might be about how many customers you will have, what price you'll pay for your raw materials, how many people you'll need to hire, and so on. You may even be developing a formal, written business plan to help you think objectively and comprehensively about what you want to do and how you'll accomplish it. However, even a formal plan will be full of assumptions you make about things you don't know.

When starting a new venture, you can lose significant amounts of time and capital before realizing your assumptions were flawed from the start or by forgetting that assumptions are assumptions, both recipes for disaster. Here are 10 dangerous business assumptions often made by entrepreneurs. Being aware of them will help you avoid some common—and dangerous—mistakes.

10 Assumptions

1. *We have no competition.*

Every business has competition. If you have no competition, then you may need to think more broadly about what your company provides. Competing products and services may fill

Audience: Entrepreneurs planning a new venture

Content: Presents common—and dangerous—assumptions entrepreneurs make in the business planning process

Outcome: Users will be able to avoid common pitfalls

the same customer need as yours, or they may come from another industry that fills a similar need.

Once you define your product market, you should do an analysis of competitors to identify the companies you are competing against and what they offer the market, as well as how well they do it. Listing their strengths and weaknesses and thinking about how you will respond to or exploit them is an important part of this process. Knowing little or nothing about your competition is evidence that you haven't done your homework.

2. *All we need is 2% of the market.*

Starting to plan a venture by saying this indicates sloppy thinking. First, it indicates that the definition of the product is too broad. Second, it indicates the lack of a plan or any marketing strategy. Making this type of a statement is a good way to think conceptually about the market, and it may be a goal to strive for, but it will not be of use when it is time to start operating the business.

Successful new business managers have to be well-informed and skillful. And they have to work very hard to achieve their goals. If the primary reason you think you'll be successful is you just need x% of the market, then you're off to a poor start.

3. Our product will sell itself.

Just existing is not enough. You have to tell your target customer that you've got the best thing for their needs. And you need to do it again and again. If your company regards marketing as a nuisance or something unimportant or top management is not actively involved, then your chances of failure increase.

In developing a plan to market yourself and your product, you will need to determine specifically how you will reach your target market. See the Purdue Extension publication *Marketing's Four P's: First Steps for New Entrepreneurs* (EC-730) for more information on marketing.

4. My financial projections are realistic.

Your financial plan will be closely examined by people who will want to know if and when you can make money. There needs to be evidence that your financial projections, in the form of an income statement, balance sheet, and statement of cash flows, are realistic and founded on sound information.

As you construct your projections, support your estimates with information about your sources and procedures; outsiders will want to know how they were determined. Explain how you calculated the numbers in your financial statements. For example: "We will sell 750 units per month at \$5.00 per unit. This is projected to increase by 2% every month for the first year. Fixed and variable costs will total \$3.75 per unit."

5. I can manage the business myself.

Probably not. Any venture has to involve collaboration. A team can be developed internally from individuals within your company, externally by advisors who are actively working on your project, or from connections to people who interact with your company. Whatever the method, a team will get you further, with fewer mistakes, than you could go alone.

But your team needs a diversity of skills and resources to be effective, and someone must have the final say. Analyzing the jobs that must be done in your company and outlining the

responsibilities and authorities of the people you work with will help you form and manage a team. See the Purdue Extension publications *Selecting and Managing Consultants* (EC-719), *Developing Effective Job Descriptions for Small Businesses and Farms* (EC-728), and *Principles for Structuring Small Businesses and Farms* (EC-729) for more information.

6. We can save money if we do it ourselves.

A common mistake that often turns out to be costly is the assumption that doing something yourself can save you money. For instance, many new business managers think they can save legal fees by setting up the business organization without the help of an attorney. But the upfront costs of professional advisors can prevent much greater fees later to unravel tangles that only an experienced attorney, for example, can foresee. Seek out and hire professional advisors.

7. Our patents will protect our business.

A well-conceived patent application can do an effective job of deterring some competitors. However, other competitors will be able to create an imitation product just different enough to allow them to be a direct competitor. Face it, if you have a good idea, someone will copy it. To create a long-term competitive advantage, make sure you deliver on your idea better than anybody else can.

8. That weakness won't matter later on.

Ignoring a negative issue won't help you. The problem isn't likely to go away, nor will it get better with time. Even seemingly small problems can mushroom and affect your chances of survival. To help decide which problems and weaknesses to address, decide how large a difference between your projected and actual performance will be acceptable.

For instance, if customer service response times in your company are twice as long as is typical in your industry and repeat business is reduced because of this, then you should address this problem immediately. Setting minimum performance standards will help to identify problems that must be addressed. Create a detailed and well-thought-out action plan that addresses each problem.

9. We can easily make enough sales to make a profit.

If your planning says that to reach profitability you need to sell your product to nearly every single customer in the market, then something is wrong. This is an extreme case, but in the market planning process you should demonstrate that the market size you can reach is achievable and at a product volume you can profitably produce.

10. We'll have plenty of available cash if the income statement shows a profit at year's end.

Cash flow and profit are not the same. While your income statement may indicate that your revenues have exceeded your expenses (a profit), it won't tell you anything about the timing of cash flows. A cash flow forecast tells you when you'll have cash and when you'll need it. The statement of projected cash flows tracks expected cash received and paid. A reasonable cash flow projection can help you plan for the eventuality of cash shortfalls, particularly in the early years.

Final Comment

As you plan, you will make assumptions about what will happen once the business gets started. Many times you will assume something about your venture—whether it is about your ability as a manager or about some part of the market—and you later forget that you made the assumption. At this point it becomes a “truth” that you believe. Believing that “truth” may hurt you as your venture develops. For instance, if you come to believe that you would be a good personnel manager of 10 employees because you could manage two employees, then your venture will suffer as you learn different. Thus, it is important to objectively question how your business will succeed from time to time.

If you thoroughly think through your venture, it is much more likely to succeed. Developing a good plan is a major task that takes a lot of work, dedication, and skill. But it is well worth the effort. As you plan, you may be able to avoid making the common assumptions listed here and thus avoid disaster.

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