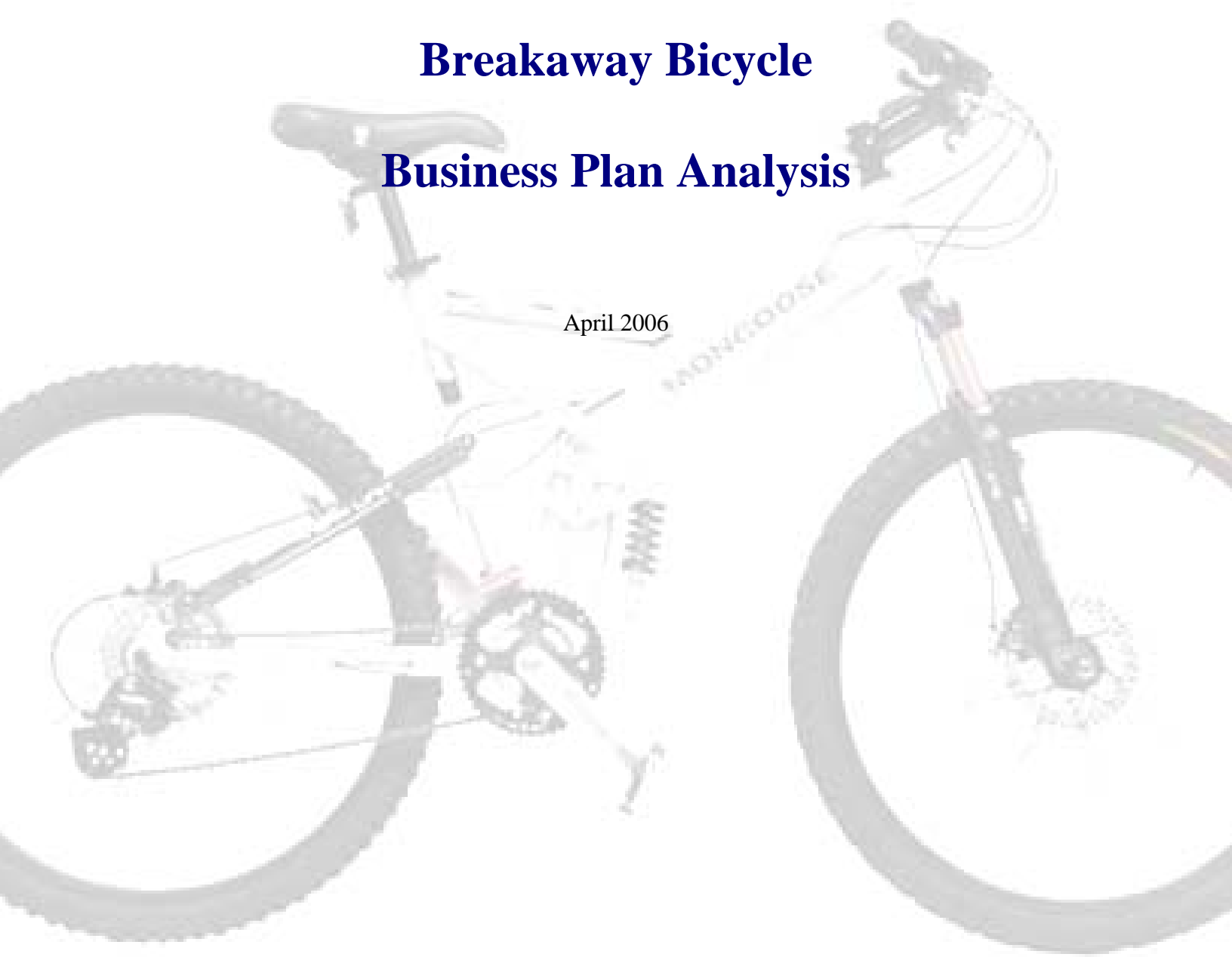


Breakaway Bicycle

Business Plan Analysis

April 2006



Executive Summary

Breakaway Bicycle Company is a small sized manufacturer of custom-built bicycles marketed to racers and enthusiasts. The company has been in business for approximately 15 years and operations have grown very modestly. The 2004 Income Statement shows gross sales of approximately \$1M and the 2004 Balance Sheet shows a company net worth of \$100,000 distributed to owners equity. The management team is seeking an outside investment to increase production capacity 43%.

Management has prepared a business plan to support the requested investment. The business plan contains insights to how the company is currently managed. Revealed are weaknesses in the probability that the current management team can grow the company

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No clear strategy is articulated, the financials contain errors indicating management does not sufficiently understand the monetary situation, and they have not considered key options to the expansion plan. Current design and production processes do demonstrate

management's ability to run the core business. As written, the business plan does not justify a prudent financial investment. Based on fundamental strengths in operations and management's knowledge of the industry, the investment decision could be reversed by developing a clear strategy supported by a strong business plan.

Introduction

Breakaway Bicycle Company (BBC) has accomplished the feat of becoming a profitable business. Management believes it is approaching full production capacity at the current location and there is additional market share to be captured, justifying expanding the business. BBC created a business plan to solicit funds to expand manufacturing operations with the objective of 15% market growth in road bike sales for the year 2000 (obvious error in the plan) with continuing growth of 3% each successive year. The mountain bike market growth rate is forecast to be much more substantial at 15% every year. BBC's business plan will increase manufacturing 43% by adding three additional

workstations and employees to the company's exiting engineer/builder work force of seven. BBC has provided financial, marketing, and forecast information to justify that funding the expansion is a sound investment. Analysis of the business plan concludes with recommendations. The business plan requires an assumption about the timeline covered due to lack of date on the plan and conflicting information. Deciphering the financial statements leads to the assumption the business plan was updated in early 2005 by editing a previous plan.

SWOT Analysis

(Strengths, Weaknesses, Opportunities, and Threats)

BBC does have strengths that it brings to the marketplace but they are not as considerable as described in the business plan. BBC is mistaken that its small size makes it more flexible and innovative. That is a policy decision that larger companies can implement and most likely exceed BBC's capability. More engineers actually enable more collaboration that can enhance a new design. BBC's primary strength is management's knowledge of the market and industry. BBC has identified the general demographics that bicycling enthusiasts are ages 24 to 45, with some college, and a medium income of

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\$40,000. Women are entering the market at a substantial rate. Knowledge of the bicycle racing industry, especially critical contacts in Europe and North America is another strength for BBC. The industry contacts enable BBC management to stay immediately current with trends and likely future developments in the

racing industry. Naturally, these contacts should be frequently informed of BBC's new products and differentiation strategy. Operational strengths include proven processes to manufacture customized bicycles and having inventory cost controls in place. Several of these strengths need to be further leveraged as opportunities.

Weaknesses – BBC does have many weaknesses typical of a small business. Not fully exploiting the strength of having key industry contacts becomes a critical weakness.

BBC either does not know how to leverage this strength or is not aware that further developed is needed. Relying exclusively on Bike Tour Magazine data for forecast projections is a weakness. Critical business decisions need data from multiple sources including contrasting viewpoints. Why were other manufacturers slow to enter the mountain bike market and chose to focus on the enthusiast road bike market? Was this a good niche decision by BBC or a lucky coincidence that mountain bikes became the trend? Immediate action should be taken to correct the lack of presence on the Internet in the year 2006. It appears management does not have sufficient knowledge regarding internet marketing, advertising, order placement, or supply chain management. Once recognized, these weaknesses are not difficult to overcome and can be converted to opportunities.

Opportunities – The opportunities BBC lists in the business plan have three major flaws. First, the reference to anticipating a 15% increase of road bike sales in the year 2000 leaves all of the information in this section (and other sections) suspect of being outdated. The second major error is poor logic that arrives at an overly optimistic market forecast. If increasing mountain bikes sales in Europe is the result of converting road bike riders to mountain bikes, how is the conclusion arrived at that both market segments will expand? It appears this is a shift in customer preference. The third mistake made by BBC is lack of seeing the enthusiast market as a major growth opportunity. While BBC acknowledges the Olympics are anticipated to grow road bike sales, there is no mention that BBC views this as an opportunity or how it will be pursued. The focus is exclusively on the racing market. Overlooked opportunities include better positioning in a growing market, further exploiting market knowledge, advertising improvements, and cost effective capacity growth. There is an opportunity to consider assigning Mr. Brown to an office in Europe to maximize contact with this critical market segment. Mr. Brown should conduct a study to determine prospects of designing and manufacturing custom bicycles in Europe to exploit the European culture of purchasing bicycles natively manufactured. Another opportunity is to expand or redirect advertising into non-bicycling venues that target the demographics of people known to become enthusiasts. There will be little or no competition from other custom manufacturers. This can expand

the market, and provide better brand recognition from the lack of competitor visibility. The weakness of no Internet presence can become an opportunity as soon as management better recognizes the need. Operationally, BBC has failed to take advantage of the opportunity to increase production with current the facility and equipment by adding additional employees on other work shifts.

Threats – BBC is correct to realize the switch to mountain bike production by the large manufactures is by far the biggest threat. They have retooled and are prepared to dominate the market. BBC may in fact not require additional capacity. The major manufacturers could take market share away from BBC. BBC's European connection is not strong enough and can be dominated by more established companies. Another weakness is management's failure to recognize that computer design of custom bicycles can be automated to adjust for size, weight, riding style, etc. of the customer. Making the process faster and less expensive. The competition is likely to pursue this improved design/manufacturing process and dedicate engineering resources to better designs. Resulting in lower costs and improved ability to bring new products to market faster than BBC. The threats to BBC are very substantial to the point of possibly eliminating almost its entire market share.

Financial Analysis

There are many problems with the BBC's financial statements. Finding a place to begin the analysis is difficult. Based on BBC's request to expand capacity it would be expected that a backlog of orders exists that is not evident from the P&L statement or the cash flow sheets or the projected revenue Pareto charts. Rather, a seasonal fluctuation in sales seems to be occurring. However, it is difficult to understand why custom bicycle sales are relatively high in January, drop off in February, and begin climbing in the spring season. Possibly this can be attributed to accrual accounting methods if a surge of orders are received in January for delivery when the weather improves. However, it is unlikely a company this size is using accrual accounting methods and it still would not explain the drop in sales for February and March. The enormous spike in December is even more confusing. Why do sales on the 2004 P&L statement leap from the lowest month in

November to the yearly high in December? December 2004 sales are 28% above the annual mean after November was 40% below the mean, a one month jump in sales of 68%. Are custom bicycles a major Christmas list item? Explain these abnormalities in the business plan. If there is a backlog of orders or a potential for a backlog of orders BBC should look for ways to place work in the slower months. Discounts or other incentives would be appropriate before expanding capacity.

Returning to the profit and loss statement, there seems to be a correlation between the advertising budget and the seasonality of sales. Probably the advertising is budget based on monthly revenue and should be reconsidered to maximize sales in the slow months. Ramping up the advertising budget a month or so before sales have traditionally slowed could be effective. The details in the expenses portion of the P&L are completely unexplainable. When comparing the 2004 P&L with 2005 there is a major error in 2004. Monthly credit card fees go from zero in 2004 to \$200 per month in 2005. Possibly BBC first began accepting credit card transactions in 2005. However, delivery expenses jump from \$200 in 2004 to \$6000 in 2005. Not easily explained. Additionally, why are delivery fees flat lined? Delivery fees should be a function of monthly sales. Looking only at the worst of the errors it is seen that telephone costs in 2004 were \$3200 per month and rent was only \$200. Finally, at the bottom of the 2004 expense section two lines for wages are found. This appears that it might be the cause for much of the 2004 data being transposed, except the top section for advertising, bad debts, and bank charges appears to be correctly tabulated. The 2004 P&L is clearly useless for analysis and casts suspicion on all the other financial statements.

The 2004 Cash Flow data is also suspicious. The \$100,000 loan proceeds, the \$60,000 capital expenditure in January, and loan principal payments indicate this is Pro Forma data, which is verified by the note at the bottom of the page. This information also conflicts with the \$200,000 request made in the Capital Equipment Purchase section of the business plan. Cash flow data for 2004 must be updated since 2004 has long since passed. The capital purchase plan needs to be depicted in the future. Moving to the

Balance Sheets, a yearend 2004 balance sheet is found as well as a Pro Forma 2004 Balance Sheet. An interesting observation on the 2004 yearend Balance Sheet is \$100,652 in owners equity. An amount equal to the financing request, if this amount appeared as retained earnings instead of owner's equity. Equally noticeable is the large jump in owners equity that occurs on both the 2004 and 2005 Pro Forma Balance sheets. BBC management is already receiving substantial salaries and should be plowing retained earnings back into the company if they truly believe growth is possible.

Easily concluded is that investing in BBC is not a wise decision at this time based on the SWOT and preliminary financial analysis. A better understanding by BBC of both internal and external environments is necessary to develop an effective strategy to defend market share as the large manufacturers begin entering the niche market BBC has enjoyed. Moreover, BBC does not understand its financial position. The financial statements are in a disastrous condition and much of the data is suspect for accuracy. BBC may or may not have its own financial resources to invest in expanded capacity if it chooses to do so.

Business Plan Narrative Analysis

BBC has gathered much of the information and data needed for a business plan but it has little value as currently written. In general, the business plan is disorganized, it is difficult to find data, the plan is not dated, the chronology of events seems incorrect, and the financial data is essentially useless. It appears to be a partially reworked business plan from several years ago and the revision is not logically thought out or edited. There are logic errors such as growth in mountain bike sales at the expense of road bike sales. Management expects to increase salaries but not product price. There is a major math error in the marketing data, 1M custom frames X \$1500 = \$1.5B, not the stated \$2.5B. Forecasts are optimistic and based on very limited information. No metrics are in place to track the effectiveness of the marketing plan. If BBC has growth opportunity limited mainly by capacity there should be a significant backlog of orders, why is it not mentioned or emphasized? Operationally there are other options regarding a strategy to increase capacity. Adding another shift, manufacturing in Europe to capture market, or a

plan that allows for further expansion outside of the present facility are just a few worth considering. There is not a timeline for the investment of funds. When will the investment begin generating revenue and when will it break even? Much of the information to build a solid business plan is available but first BBC must develop a strategy that the business plan will support.

Profitability and Competitiveness Recommendations

The first need is to rework of all the current financial statements, extract reliable data from historical company financial data for trend analysis, and create reliable forward looking financial projections based on research and attention to detail so that profitability today and in the future can be determined. Add an assumptions page to communicate the logic behind the numbers. Conducted a breakeven analysis based on the planned capacity expansion. However, conduct a comprehensive study of the market forecast before expansion is considered. Organizing and reviewing this data may lead to a different conclusion than to expand and it will be needed to develop an overall business strategy.

A detailed strategy incorporating SWOT information, market information, and clearly defining if BBC is only pursuing the racing market or expanding into the enthusiasts market must be developed to guide the business. A thorough marketing plan that more effectively uses the advertising budget and better use of contacts in the European market are also necessary. BBC needs a technology study. A dynamic website is necessary from BBC's business and the design process can be accomplished for lower cost, faster, while freeing up engineering to bring new products to market quicker. BBC has the technical knowledge and basic processes to run a profitable business. Management must understand and communicate a well-developed strategy.

Solidify the Strategy

- Incorporate SWOT information
- Act on market knowledge
- Clearly define targeted market
- Dynamic web site now
- Communicate the Strategy