

ENTREPRENEURSHIP [MGMT 2141]

MODULE



DEPARTMENT OF MANAGEMENT
COLLEGE OF BUSINESS AND ECONOMICS
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PREFACE

Entrepreneurship is a vital source of change in all facets of society, empowering individuals to seek opportunity where others see insurmountable problems. For the past century, entrepreneurs have created many great enterprises that subsequently led to job creation, improved productivity, increased prosperity, and a higher quality of life. With one-third of the world's population lacking access to basic energy needs and two-thirds with annual incomes of less than \$2,000, entrepreneurship can play an important role in finding solutions to these challenges facing civilization.

Approach

Just as entrepreneurs combine things to create innovations, I integrate the most valuable entrepreneurship management theories from some of the world's leading scholars, educators, and authors. I also provide an action-oriented approach to the subject through the use of examples, and checkpoint questions. By striking a balance between theory and practice, I hope readers will benefit from both perspectives.

My comprehensive collection of concepts and applications provides the tools necessary for success in starting and growing a new enterprise. I tried to show the critical differences between scientific ideas and true business opportunities.

Audience

This module is designed and prepared for distance students of Arbaminch University, as well as others who seek to learn the essentials of entrepreneurship. No prerequisite knowledge is necessary, although an understanding of basic business principles will prove useful.

Features

The material is organized in a modular format to allow for both systematic learning and random access of the material to suit the needs of any reader seeking to learn how to grow successful ventures. Readers focused on business plan development should consider placing a higher priority on chapter six. Regardless of the immediate learning goals, the module is a handy reference and companion tool for future use. Each chapter opens with introduction followed by chapter objectives and in-between subtopics key progress checking questions are presented.

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Course Introduction

Dear Learner, well come to the course ***Entrepreneurship and Small Business Management***. This interdisciplinary course is designed to introduce students to the concept of sustainable entrepreneurship, a manageable process that can be applied across careers and work settings. It focuses on building entrepreneurial attitudes and behaviors that will lead to creative solution within community and organizational environments. Course topics include the history of entrepreneurship, the role of entrepreneurs in the 21st century global economy, and the identification of entrepreneurial opportunities. The elements of creative problem solving, the development of a business concept/model, the examination of feasibility studies and the social /moral/ethical implication of entrepreneurship will be incorporated. Issues related to starting and financing a new venture is included. To properly the issue discussed in the module and to properly achieve the objective of the course, you will be required to devote ample time to study.

The course is designed in such a way that the reader will be exposed to such entrepreneurship and small business management. To achieve its objective the module is divided in to seven chapters which further divided in to different sections and sub- sections. The first chapter introduces you about the nature and meaning of entrepreneurship, the second chapter is about small business management, the third is business plan preparation, the fourth is product and technology, the fifth is the marketing of small business , the sixth is about finance and the last chapter is about managing growth and transition

To support you in your learning efforts, the module includes numerous learning activities, in-text questions, self-check exercises glossaries and checklists. If the student is to get the maximum benefit out of the material he/she is strongly advised to make use of these learning aids. For the reader to cross check the answers for activities and self- check questions given in the module, possible answers are provided at the end of each module.

It is our belief that the material will be interactive, lucid self- contained and self- explanatory. It will help you easily understand both broad and narrow issues in the field of ***Entrepreneurship and Small Business Management*** that is needed to be a good individual in this business world.

Objectives of the course:

At the end of this course students will be able to:

- ☐ *Define entrepreneurship within the context of society; organizations and individuals.*
- ☐ *Understand more about the specific management issues involved in setting up and running a small enterprise.*
- ☐ *Demonstrate an understanding of the impact of entrepreneurship on the economy.*
- ☐ *Recognize and overcome obstacles to creative problem-solving.*
- ☐ *Describe the element of an effective business model/plan.*
- ☐ *Develop a concept for an innovative product or service in his or her own area of interest.*
- ☐ *Recognize that entrepreneurial success in the 21st century depends on teamwork and diversity.*
- ☐ *Develop a personal framework for managing the ethical dilemmas and social responsibilities facing entrepreneurs.*
- ☐ *Describe the leadership studies of entrepreneurs who have been successful in different sectors (e.g., start-ups, corporations. Community, public sector, etc.).*
- ☐ *Equipped with the basic knowledge and skills of starting and operating a business for they will be the future managers (or even Owner-managers) of these firms.*
- ☐ *Identify traits/characteristics of an entrepreneur/ entrepreneurs as exhibited in behavior.*
- ☐ *Analyze elements of the entrepreneurial mind set and discuss the implications for functioning as a successful entrepreneur*

CHAPTER ONE

ENTREPRENEURSHIP AND FREE ENTERPRISE

1.1 Introduction

Today you are about to start exploring all fascinating issues of Entrepreneurship and to get answers for the questions that have been ringing in your mind for long period. This is the entrepreneurial age. It is estimated that as many as 460 million persons worldwide were either actively involved in trying to start a new venture or were owner-managers of a new business in 2002. More than thousand new businesses are born every hour of every working day in the United States. Entrepreneurs are driving a revolution that is transforming and renewing economies worldwide. Entrepreneurship is the essence of free enterprise because the birth of new businesses gives a market economy its vitality.

New and emerging businesses create a very large proportion of innovative products and services that transform the way we work and live, such as personal computers, software, the Internet, biotechnology drugs, and overnight package deliveries. They generate most of the new jobs. *For example, from 1990 to 1994, small, growing firms with 100 or fewer workers generated 7 to 8 million new jobs in the U.S. economy, whereas firms with more than 100 workers destroyed 3.6 million jobs.* In 1998 to 1999, the last period for which data are available, small business accounted for two-thirds of the 2.6 million net new jobs.

By the way, what is Entrepreneurship? What is the difference between entrepreneur, and owner manager? What are the factors affecting entrepreneurship? What are the contributions of entrepreneurship to the national economy? Dear students! In this chapter, you will get all the answers for the above questions. This chapter deals with the meaning the nature, definition, the types, the difference between entrepreneur and owner manager and other issues.

At the end of this chapter you will get self-checking exercises. These exercises are set to test your level of understanding of the topics covered in this chapter. We strongly advise you to attempt them before you proceed to read the next chapter.

Chapter objectives

Up on the completion of this chapter students are expected to know:

- ☐ Define the term entrepreneurship and entrepreneur
- ☐ Identify types of entrepreneur
- ☐ Recognize the role of entrepreneurship in the economy
- ☐ Analyze the entrepreneurial competences
- ☐ Understand creativity and innovation



Brain storming Questions

Do you know that there are a number of unemployed youth in the country and by the time you graduate, this number would have increased substantially? Do you want to be part of that group which keeps knocking from pillar to post, checking with employment exchanges, relatives, friends, and neighbors and still not able to get a job to their liking and then settle for a second or third rate job?

1.2. Historical Origin of Entrepreneurship

What is entrepreneurship? And who is an entrepreneur? These two questions are asked more frequently reflecting the increasing demand in the field of entrepreneurship. Offering a specific and unambiguous definition of the term entrepreneurship /entrepreneur presents a challenge. This is not because definitions are not available, but because there are so many. Here let us look into the historical development of entrepreneurship so as to grasp the meaning of the word entrepreneurship.

During the ancient period the word entrepreneur was used to refer to a person managing large commercial projects through the resources provided to him.

In the 17th Century a person who has signed a contractual agreement with the government to provide stipulated products or to perform service was considered as entrepreneur. In this case the contract price is fixed so any resulting profit or loss reflects the effort of the entrepreneur. In the 18th Century the first theory of entrepreneur has been developed by Richard Cantillon. He said that an entrepreneur is a risk taker. If we consider the merchant, farmers and /or the professionals they all operate at risk. For example, the merchants buy products at a known price and sell it at unknown price and this shows that they are operating at risk. The other development during the 18th Century is the differentiation of the entrepreneurial role from capital providing role. The later role is the base for today's venture capitalist. In the late 19th and early 20th Century an entrepreneur was viewed from economic perspectives. The

entrepreneur organizes and operates an enterprise for personal gain. In the middle of the 20th

Century the notion of an entrepreneur as an inventor as established. “The function of the entrepreneur is to reform or revolutionize the pattern of production by exploiting an invention or more generally untried technological possibility for producing new commodities or producing an old one in a new way or opening a new outlet for products by reorganizing a new industry.”

The concept of innovation and newness are at the heart of the above definition. From the historical development it is possible to understand the fact that the perception of the word entrepreneur was evolved from managing commercial project to the application of innovation (creativity) in the business idea.

1.3 Definitions of Entrepreneurship and Entrepreneur

Here we will see some definitions of entrepreneurship and entrepreneur. Intuitively, it is known that entrepreneurship is the process and entrepreneur is the person undertaking entrepreneurial activity such as undertaking own business. Finally we will see the common attributes of the definitions of entrepreneurship and entrepreneur.

1. Entrepreneurship is the process of identifying opportunities in the market place, arranging the resources required to pursue these opportunities and investing the resources to exploit the opportunities for long term gains. It involves creating incremental wealth by bringing together resources in new ways to start and operate an enterprise.
2. Entrepreneurship is the processes through which individuals become aware of business ownership then develop ideas for, and initiate a business.
3. Entrepreneurship can also be defined as the process of creating something different and better with value by devoting the necessary time and effort by assuming the accompanying financial, psychic and social risks and receiving the resulting monetary reward and personal satisfaction. In this case an individual should come up with something different and better in order to be named as entrepreneur.
4. Entrepreneurship is the art of identifying viable business opportunities and mobilizing resources to convert those opportunities into a successful enterprise through creativity, innovation, risk taking and progressive imagination.

Entrepreneurship is a practice and a process that results in creativity, innovation and enterprise development and growth. It refers to an individual's ability to turn ideas into action involving and

engaging in socially-useful wealth creation through application of innovative thinking and execution to meet consumer needs, using one's own labor, time and ideas. Engaging in entrepreneurship shifts people from being "job seekers" to "job creators", which is critical in countries that have high levels of unemployment. It requires a lot of creativity which is the driving force behind innovation.

In general, the process of entrepreneurship includes five critical elements. These are:

- 1) The ability to perceive an opportunity.
- 2) The ability to commercialize the perceived opportunity i.e. innovation
- 3) The ability to pursue it on a sustainable basis.
- 4) The ability to pursue it through systematic means.
- 5) The acceptance of risk or failure.

Based on the above concepts of entrepreneurship, an entrepreneur can be defined as follows:

- 1) An entrepreneur is any person who creates and develops a business idea and takes the risk of setting up an enterprise to produce a product or service which satisfies customer needs.
- 2) An entrepreneur can also be defined as a professional who discovers a business opportunity to produce improved or new goods and services and identifies a way in which resources required can be mobilized.
- 3) An entrepreneur is an individual who: has the ability to identify and pursue a business opportunity; undertakes a business venture; raises the capital to finance it; gathers the necessary physical, financial and human resources needed to operate the business venture; sets goals for him/herself and others; initiates appropriate action to ensure success; and assumes all or a major portion of the risk!
- 4) An entrepreneur is a person who: create the job not a job-seeker; has a dream, has a vision; willing to take the risk and makes something out of nothing
- 5) Other definition, views the term entrepreneur from three perspectives; i.e. from the economist, psychologist and capitalist philosopher's point of view.
 - i) To an economist an entrepreneur is one who brings resource, labor, materials, and other assets into combination that makes their value greater than before and also one who introduces changes innovations.
 - ii) To a psychologist an entrepreneur is a person typically driven by certain forces need to obtain or attain something, to experiment, to accomplish or perhaps to escape the authority of others.

- iii) For the capitalist philosopher an entrepreneur is one who creates wealth for others as well, who finds better way to utilize resources and reduce waste and who produce job others are glad to get.

In general, entrepreneur refers to the person and entrepreneurship defines the process. Both men and women can be successful entrepreneurs; it has nothing to do with gender. All entrepreneurs are business persons, but not all business persons are entrepreneurs.

1.4 Types of Entrepreneurs

Entrepreneurship can take three different forms. They are:

- **The individual entrepreneur:** An individual entrepreneur is someone who started; acquired or franchised his/her own independent organization. The major portion of this module is also devoted to describe the basic features and activities of the individual entrepreneur.
- **Intrapreneur:** An Intrapreneur is a person who does entrepreneurial work within large organization. The process by which an intrapreneur affects change is called Intrapreneurship.
There are two facts about intrapreneurship. The Intrapreneur's context is often large and bureaucratic organization whereas the individual entrepreneur operates in the broader, more flexible economic market place. Intrapreneurs are individuals who often engage in the entrepreneurial actions in large organizations without the blessing of their organizations.
- **The Entrepreneurial Organization:** The entrepreneurial function need not be embodied in a physical person. Every social environment has its own way of filling the entrepreneurial function.

Individuals working in organizations have the potential for being, as do those working independently to start their own business. An organization can create an environment in which all of its members can contribute in some function to the entrepreneurial function.

An organization that creates such an internal environment is defined as entrepreneurial organization.

1.5 Role of Entrepreneurs in Economic Development

Entrepreneurial development is the most important input in the economic development of any country. The objectives of industrial development, balanced regional growth, and generation of employment opportunities are achievable through entrepreneurial development. Entrepreneurs are at the core of industrial development which results in greater employment opportunities to the unemployed youth, increase in per capita income, higher standard of living and increased revenue to the government in the

form of income, sales tax, export duties, import duties etc. The entrepreneurs serve as a key to the creation of new enterprises, thereby rejuvenating economy and sustaining the process of economic development in the following ways:

- 1) **Improvement in per capita Income/Wealth Generation:** Entrepreneurs play a vital in the economic development of a region. From the fall of Rome (AD 476) to the eighteenth century, there was virtually no increase in per capita wealth generation in the West. With the advent of entrepreneurship, however, per capita wealth generation and income in the west grew exponentially by 20 Percent in the 1700s, 200 percent in the 1800s, 740 percent in the 1900 (Drayton, 2004).
- 2) **Generation of Employment Opportunities:** By creating a new business enterprise, entrepreneurs generate employment opportunities for others. Unemployment is a major issue, especially in the context of developing economies like Ethiopia. Educated youth often are unable to get to get a suitable employment themselves. Thus, entrepreneurs not only self-employ themselves, but also create jobs for others.
- 3) **Inspire others Towards Entrepreneurship:** The team created by an entrepreneur for his new undertaking often provides the opportunity for the employees to have a first-hand experience of getting involved in an entrepreneurial Venture. An existing venture provides a number of entrepreneurial opportunities through forward and backward linkages, to these employees even to become entrepreneurs themselves. Thus, this process helps in forming a chain reaction of entrepreneurial activity which directly contributes to the health of the economy.
- 4) **Balanced Regional Development:** Entrepreneurs help to remove regional disparities in economic development. They set up the industries in the backward areas to avail various subsidies and incentives offered by the Central and State Governments, thereby balancing the economic growth in different regions in the country.
- 5) **Enhance the Number of Enterprise:** When new firms are created by entrepreneurs, the number of enterprises based upon new ideas/ concepts/ products in a region increases. Not only does an increase in the number of firms enhance the competition for new ideas, but greater competition across firms also facilitates the entry of new firms specializing in a particular new product or service. This is because the necessary complementary inputs are more likely available from small specialist niche firms than from large vertically integrated products (Jacobs, 1969).
- 6) **Provide Diversity in Firms:** Entrepreneurial activity often results into creation of a variety of firms in a region. These firms operate into diverse activities and it has been found that it is this

diversity in firms which fosters economic development and growth rather than homogeneity. According to Jacobs (1969), it is the exchange of complementary knowledge across diverse firms and economic agents that yield an important return on new economic knowledge.

- 7) **Economic Independence:** Entrepreneurship is essential for self-reliance for a country. Entrepreneurs create industries that manufacture indigenous substitutes, thereby reducing the dependence on imports. Also, the goods are exported to other countries to earn foreign exchange. This import substitution and export promotion results in more economic independence to the country
- 8) **Combine Economic factors:** All the products bought and sold in an economy are a mix of three primary economic factors (the raw materials, nature offers up, the physical and mental labor people provide and capital (money)). Now value is created by combining these three things together in a way which satisfies human needs.
- 9) **Provide Market efficiency:** Efficient means resources are distributed in an optimal way that is the satisfaction that people can gain from them is maximized. An economic system can only reach this state if there is competition between different suppliers. If a supplier is not using competition then they will tend to demand profit in excess of what the market would allow and reduce the overall efficiency of the system
- 10) **Accepting Risk:** Risk is the potential variation in terms of future outcomes. We do not know exactly what the future will bring. This lack of knowledge creates uncertainty. No matter how we plan there is always a possibility of adverse deviation from what we expect or hoped for. Here the primary function of the entrepreneur is to accept risk on behalf of other people.
- 11) **Maximize Investor's Return:** Entrepreneurs create and run organizations which maximize long-term profit on behalf of the investors which in turn generates overall economic efficiency.

1.6 Entrepreneurial Competence and Environment

Under this topic entrepreneurial mindset (that will address subtopics such as, who become an entrepreneur; qualities of successful entrepreneurs; entrepreneurial skills; the entrepreneur's task and wealth of the entrepreneur), and Entrepreneurship and Environment.

1.6.1 Entrepreneurial Mindset

1.6.1.1 Who Becomes an Entrepreneur?

Anyone with the following characteristics can be an entrepreneur.

- 1) **The Young Professional:** Increasingly young highly educated people often with

entrepreneurial qualifications are skipping the experience of working for an established organization and moving directly to work on establishing their own ventures.

- 2) **The Inventor:** The inventor is someone who has developed an innovation and who has decided to make a career out of presenting that innovation to the market. It may be a new product or it may be an idea for a new service. It may be a high-tech or it may be based on a traditional technology.
- 3) **The Excluded:** Some people turn to an entrepreneurial career because nothing is open to them. Displaced communities and ethnic and religious minorities have not been invited to join the wider economic community due to a variety of social, cultural and political and historical reasons. As a result they may form their own internal networks, trading among themselves and, perhaps, with their ancestral countries.

1.6.1.2 Qualities of an Entrepreneur

In order to be successful, an entrepreneur should have the following qualities:

- ☐ Opportunity-seeking
- ☐ Persevering
- ☐ Risk Taking
- ☐ Demanding for efficiency and quality
- ☐ Information-seeking
- ☐ Goal Setting
- ☐ Planning
- ☐ Persuasion and networking
- ☐ Building self-confidence
- ☐ Listening to others
- ☐ Demonstrating leadership

- 1) **Opportunity-seeking:** An opportunity is a favorable set of circumstances that creates a need for a new product, service or business. It includes access to credit, working premises, education, trainings etc. An entrepreneur always seeks out and identifies opportunities. He/she seizes an opportunity and converts it into a realistic and achievable goal or plan.
- 2) **Persevering:** An entrepreneur always makes concerted efforts towards the successful completion of a goal. An entrepreneur perseveres and is undeterred by uncertainties, risks, obstacles, or difficulties which could challenge the achievement of the ultimate goal.

Activity 1.1: Understanding perseverance

Objective of activity: To enable students to internalize the concept of perseverance

The story of Thomas Edison (please adapt to the context)

When he was young, Thomas Edison's parents took him out of school after his teachers declared that he was "stupid" and "unteachable." Edison spent his early years working and being fired from various jobs, culminating in his firing from a telegraph company at the age of 21. Despite these numerous setbacks, Edison was never discouraged from his true calling in life: inventing! Throughout his career, Edison obtained more than one thousand patents. And although several of these inventions such as the light bulb, stock printer, phonograph and alkaline battery -- were groundbreaking innovations, the vast majority of could be fairly described as failures. Edison is now famous for saying that genius is one of Edison's best examples of perseverance occurred after he was already a successful man. After inventing the light bulb, he began seeking an inexpensive light bulb filament. At the time, ore was mined in the Midwest of the United States, and shipping costs were very high. In order to minimize his costs with ore, Edison established his own ore-mining plant in Ogdensburg, New Jersey. For nearly ten years, he devoted his time and money to the enterprise. Edison also obtained 47 patents for innovations that helped make the plant run more smoothly. And even despite those inventions, Edison's core project failed because of the low quality of ore on the East Coast.

However, despite that failing, one of those 47 inventions (a crushing machine) revolutionized the cement industry, and actually earned Edison back almost all of the money he had lost. Later, Henry Ford would credit Edison's Ogdensburg project as the main inspiration for his Model T Ford assembly line. And in fact, many believe that Edison paved the way for modern-day industrial laboratories. Edison's foray into ore-mining demonstrates that dedication can pay off even in a losing venture.

Instructions: Read the story of Thomas Edison for the students

Reflection questions:

- A. What are the major challenges that Thomas Edison faced?
- B. What were his achievements?
- C. What are the causes for his success?
- D. What do we learn from the story of Thomas Edison?

B. Risk Taking: The best entrepreneurs tend to:-

Set their own objectives where there is moderate risk of failure and take calculated risks
Gain satisfaction from completing a job well

Not be afraid of public opinion, skepticism

Take responsibility for their own actions

Importance of Risk-taking

- ☐ Build self confidence
- ☐ Create a feeling of leadership
- ☐ Create strong motivation to complete a job well

4) Demanding for Efficiency and Quality

Efficiency: Being efficient means producing results with little wasted effort.

Quality refers to:

1. The ongoing process of education, communication, evaluation and constant improvement of goods/services to meet the customer's need in a way that exceeds the customer's expectations;
2. A characteristic of the product or service that makes it fit to use. It makes a product, process, or service desirable.
3. The ability of a product or service to meet a customer's expectations for that product or service.

The importance of quality management in entrepreneurship is reflected in the income statement of the business. There is always a demand for quality products and efficient services. Quality plays an important role in this new era of globalization because it confers certain benefits which include:

- ☐ **Reduction of waste:** Striving to maintain quality means examining all processes that contribute to the creation of a product, to remove non-productive processes and waste. If businesses keep to their standard of maintaining the quality of the product, the number of defective products will be reduced. Consumers prefer to buy quality products. Hence the quality products/services help in increasing the share in market and ensure that they will not be returned.
- ☐ **Cost-effectiveness:** Striving to ensure quality helps businesses to minimize the chances that they will make mistakes. As a result, the costs of re-doing work or changing the product after it has been sold are greatly reduced.
- ☐ **An increase in market share:** Customers prefer to buy the same product again and again if they are satisfied with the quality. If they are satisfied with the quality of a product, then they will not only purchase the product/services more than once, but they will also recommend it to their friends. As a result, this contributes to an increase in the company's market share.

- ❑ **Better profitability:** Better quality of product satisfies customers. Increased customers means increase sales, increased shares in market and consequently increased profits.
- ❑ **Social responsibility:** By providing quality products and services, a company is more likely to be able to fulfill its responsibility to the community and meet standards set by government.
- ❑ **Reputation:** Quality of goods and services improves the reputation of the business for competition in the market and growth.

4) **Information-seeking:** Successful entrepreneurs do not rely on guesswork and do not rely on others for information. Instead, they spend time collecting information about their customers, competitors, suppliers, relevant technology and markets. Gathering relevant information is important to ensure that the entrepreneur makes well informed decisions. Information on the area of market, supply, operations, finance, legislation, and infrastructure are important for entrepreneurs.

6) Goal Setting

A Goal - is a general direction, or long-term aim that you want to accomplish. It is not specific enough to be measured. It is large in scope, not necessarily time-bound, and is something that people strive for by meeting certain objectives which will hopefully add up to eventually achieving the goal.

Objectives - are specific and measurable. They are concise and specific. Think of the word “**object.**” You can touch it, it’s there, it’s actual, and it’s finite.

An entrepreneur must have a goal and an objective which is specific, measurable, attainable relevant, and time bound (SMART).

- ❑ **Specific:** Great goals are well-defined and focused. The moment you focus on a goal, your goal becomes a magnet, pulling you and your resources toward it. The more focused your energies, the more power you generate.
- ❑ **Measurable:** A goal without a measurable outcome is like a sports competition without a scoreboard or scorekeeper. Numbers are an essential part of business. Put concrete numbers in your goals to know if you’re on track.

Attainable: Far too often, entrepreneurs can set goals which are beyond their reach.

Dream big and aim for the stars but keep one foot firmly based in reality.

- ❑ **Relevant:** Achievable business goals are based on the current conditions and realities of the business climate. For example, you may desire to have your best year in business or increase revenue by 50%, but if a national economic crisis is looming and three new competitors just opened in your market, then your goals are not relevant to the realities of the market.

- ☐ Time-Based: Business goals and objectives just don't get done when there's no time frame tied to the goal-setting process. Whether your business goal is to increase revenue by 20% or to find two new clients, it is important to choose a time-frame to accomplish your goal.

7) **Planning:** Planning is making a decision about the future in terms of what to do, when to do, where to do, how to do, by whom to do and using what resources. An effective entrepreneur therefore usually plans his/her activities and accounts as best as they can for unexpected eventualities.

8) Persuasion and Networking

Persuasion is a way of convincing someone to get something or make a decision in your favor. It is inducing or taking a course of action or embracing a point of view by means of argument, reasoning, or entreaty; to convince; to succeed in causing a person to do or consent to something; to win someone over, as by reasoning or personal forcefulness; to cause to believe; to induce, urge, or prevail upon successfully.

Importance of Persuasion in Business

- ☐ We purchase goods from people
- ☐ We sell goods to people
- ☐ We need support from people
- ☐ We work with people.

Without people, be they are suppliers, workers, and most importantly customers, there is no business.

Networking is an extended group of people with similar interests or concerns who interact and remain in informal contact for mutual assistance or support. In a business environment where we are in, we network with customers, suppliers, competitors, various firms, different organizations, government offices and family, etc.

Factors that Affect Persuasion and Networking

- ☐ Socio-cultural background and perceptions
- ☐ Communication skills (both verbal and non-verbal).
- ☐ Negotiation skills

9) **Building Self-confidence:** Self-confidence is the state of being certain that a chosen course of action is the best or most effective given the circumstances. Confidence can be described as a subjective, emotional state of mind, but is also represented statistically as a confidence level within which one may be certain that a hypothesis will either be rejected or deemed plausible. Self-confidence is having confidence in oneself when considering a capability. Overconfidence is

having unmerited confidence-believing something or someone is capable when they are not.

Characteristics of a Self-confident Person

A person with self-confidence may exhibit some of the following characteristics:

- ☐ Risk-taking: willing to take risks and go the extra mile to achieve better things.
- ☐ Independent: entrepreneurs like to be their own masters and want to be responsible for their own decisions.
- ☐ Perseverance: Ability to endure and survive setbacks and continue to build confidence in whatever you do in your business.
- ☐ Able to learn to live with failure. Entrepreneurs are going to make mistakes. They are human. But they learn from these mistakes and then move on.
- ☐ Ability to find happiness and contentment in work.
- ☐ Doing what you believe to be right, even if others mock or criticize you for it. Admitting mistakes and learning from them

Activity

1) Think about your life so far, and list the five major achievements in personal life.

1. _____ 2. _____
3. _____ 4. _____
5. _____

2) Think about your strengths in running your personal life. Write four of them which you are most proud of?

1. _____ 3. _____
2. _____ 4. _____

3) Think about what's important to you, and where you envision your business in the future. What is the goal of your business?

4) Build the knowledge and skills that you need to succeed. What do you need to know, do or learn in order to accomplish the business goal stated above?

5) How do you think you can acquire this knowledge and these skills so that you will be able to move forward confidently?

6) When you are starting, do not try to do anything clever or elaborate. There is no need to be perfect – just enjoy doing simple things successfully and well. Focus on the basics, set small goals and achieve them, and you will find yourself accelerating towards success! So, what basics or initial steps will you take towards reaching your goal?

10) Listening to Others: An entrepreneur does not simply impose his/her idea on others. Rather, he/she listens to other people in their sphere of influence, analyses their input in line with his/her own thinking and makes an informed decision.

11) Demonstrating Leadership: An entrepreneur does not only do things by him/herself, but also gets things done through others. Entrepreneurs inspire, encourage and lead others to undertake the given duties in time.

Self-assessment

Activity 3: Complete a self-assessment of your entrepreneurial qualities

Go through the statements below and score yourself to the best of your ability and as honestly as possible. Do not take too long thinking about any one answer, your first guess is probably the most accurate. Use the scoring key below.

Scoring:

5 – Always 4 – Often 3 – Sometimes 2 – Rarely 1 – Never

1.	I enjoy doing things on my own. Nobody has to motivate me to get started on a task.				
2.	If I make up my mind to do something, I don't let anything stop me.				
3.	I do not hesitate to undertake risks related to creating and operating an enterprise.				
4.	I plan my time and resources well so I produce high quality products.				
5.	I assess the time and capacity I have before I commit to accomplishing a job.				
6.	I act upon the opportunities that needs and problems present.				
7.	I keep trying again and again despite great challenges and failure.				
8.	I work hard to try to foresee potential risks so as to prevent future risk.				
9.	I make personal sacrifices to complete jobs in order to keep my word and meet promised deadlines.				
10.	I always strive for improvement and progress despite feedback from people that they are satisfied with my work.				
11.	Before undertaking my job I try to gain as much information about it as I can, and verify the accuracy of the information I am receiving.				
12.	I set short and long-term goals for my personal life and business.				
13.	I do everything I can to accomplish set business goals, through careful planning and implementation.				
14.	I team up well with others for tasks which I cannot accomplish on my own.				

Analysis two: Add up your total score from all the numbers you wrote in each row. Write your total sum here, and then interpret it below:

Total Sum = _____

Result Interpretation:

Score	Meaning
< 50:	Limited entrepreneurial qualities at the moment. It does not mean you are not meant to be a businessperson. It only means that you should spend more time preparing yourself to handle any problems you might face once you start a business.
Between 50 – 80	Average - there are gaps that need to be filled or improved upon. You might consider upgrading your knowledge or skills. Consider taking some courses.
>80	Good entrepreneur - keep it up and continue to develop.

1.6.1.3 Entrepreneurial Skills

A skill is simply knowledge which is demonstrated by action. It is an ability to perform in a certain way. An entrepreneur is someone who has a good business idea and can turn that idea into reality. To be successful, an entrepreneur must not only identify an opportunity but also understand it in great depth. He or she must be able to spot a gap in the market and recognize what new products or services fill the gap. He or she must know what features it will have and why they will appeal to the customer. The entrepreneur must also know how to inform the customer about it and how to deliver the new offerings. All this calls for an intimate knowledge of a particular sector of industry. Turning an idea into reality calls upon two sorts of skills, these are:

- I. General management skills and
- II. People management skills

I) General Management Skills: These are skills required to organize the physical and financial resources needed to run the venture. Some of the most important general management business skills are:

- ☐ **Strategy Skills** – An ability to consider the business as a whole, to understand how it fits within its market place, how it can organize itself to deliver value to its customers, and the ways in which it does this better than its competitors.
- ☐ **Planning Skills** – An ability to consider what the future might offer, how it will impact on the business and what needs to be done to prepare for it now.
- ☐ **Marketing Skills** – An ability to see past the firm’s offerings and their features, to be able to see how they satisfy the customer’s needs and why the customer finds them attractive.
- ☐ **Financial Skills** – An ability to manage money; to be able to keep track of expenditure and to monitor cash-flow, but also an ability to assess investments in terms of their potential and their risks.
- ☐ **Project Management Skills** – An ability to organize projects, to set specific objectives, to set schedules and to ensure that the necessary resources are in the right place at the right time.
- ☐ **Time Management Skills** – An ability to use time productively, to be able to prioritize important jobs and to get things done on schedule.

II) People Management Skills: Businesses are made by people. A business can only be successful if the people who make it up are properly directed and are committed to make an effort on its behalf. An entrepreneurial venture also needs the support of people from outside the organization such as customers, suppliers and investors. To be effective, an entrepreneur needs to demonstrate a wide variety of skills in the way he/she deals with other people. Some of the more important skills we might include under this heading are:

- ☐ **Communication Skills** – An ability to use spoken and written language to express ideas and inform others.
- ☐ **Leadership Skills** – An ability to inspire people to work in a specific way and to undertake the tasks that are necessary for the success of the venture.
- ☐ **Motivation Skills** – An ability to enthuse people and get them to give their full commitment to the tasks in hand. Being able to motivate demands an understanding of what drives people and what they expect from their jobs.
- ☐ **Delegation Skills** – An ability to allocate tasks to different people. Effective delegation involves more than instructing. It demands a full understanding of the skills that people possess how they use them and how they might be developed to fulfill future needs.
- ☐ **Negotiation Skills** – An ability to understand what is wanted from a situation, what is motivating others in that situation and recognize the possibilities of maximizing the outcomes

for all parties.

All these different people skills are interrelated. Here entrepreneurial performance results from a combination of industry knowledge, general management skills; people skills and personal motivation (see the figure shown below). The successful entrepreneur must not only use these skills but learn to use them and to learn from using them. Entrepreneurs should constantly avoid their abilities in these areas, recognize their strengths and weaknesses, and plan how to develop these skills in the future.

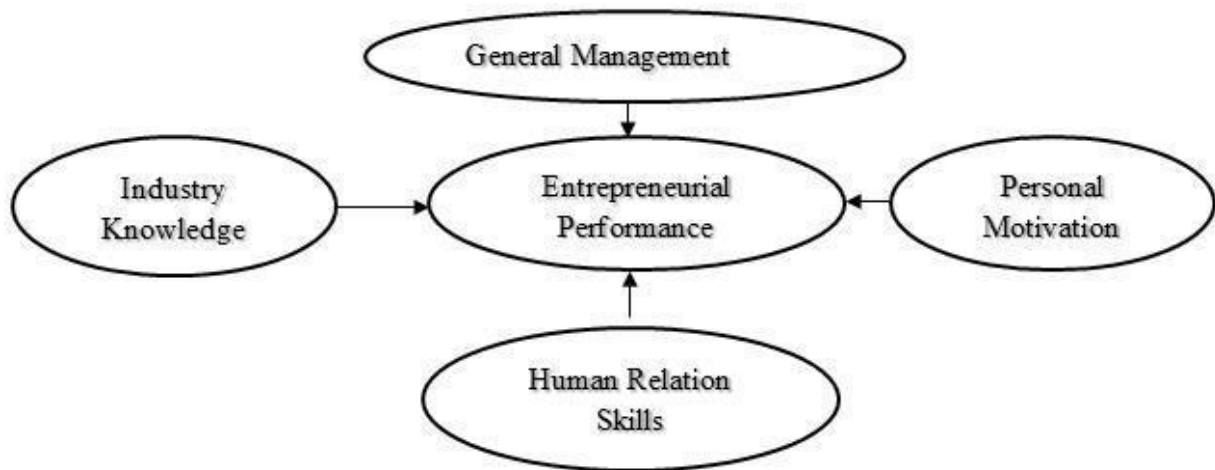


Fig1.1: entrepreneurial skills

1.6.1.4 The Entrepreneurial Tasks

We recognize entrepreneurs, first and foremost, by what they actually do – by the tasks they undertake. A number of tasks have been associated with the entrepreneur. Some of the more important are:

- 1) **Owning Organizations:** Ownership lies with those who invest in the business and own its stock – the principals, while the actual running is delegated to professional agents or managers. Therefore, if an entrepreneur actually owns the business then he is in fact undertaking two roles at the same time that of an investor and that of a manager. Here we can also recognize many people as entrepreneur even if they do not own the venture they are managing.
- 2) **Founding New Organizations:** The entrepreneur is recognized as the person who undertakes the task of bringing together the different elements of the organization (people, property, productive resource, etc.) and giving them a separate legal entity. The entrepreneur makes major changes in their organizational word.
- 3) **Bringing Innovations to Market:** The idea of innovation encompasses any new way of doing something so that value is created. Innovation can mean a new product or service but it can also include a new way of delivering an existing product or service, new methods of informing the consumer about the product or new ways of organizing the company.

- 4) **Identification of Market Opportunity:** An opportunity is the gap in a market where the potential exists to do something better and create value. New opportunities exist all the time but they do not necessarily present themselves. If they are to be exploited they must be actively sought out. Note that opportunity always takes priority over innovation.
- 5) **Application of Expertise:** A slight more technical notion is that they have a special ability in deciding how to allocate scarce resources in situations where information is limited. It is their expertise in doing this that makes entrepreneurs valuable to investors.
- 6) **Provision of leadership:** Entrepreneurs can rarely drive their innovation to market on their own. They need the support of other people both from their organizations and from people outside such as investor customer and supplier.
- 7) **The entrepreneur as manager:** At the end of the day the entrepreneur is a manager. The distinction between an entrepreneur and ordinary manager may lie on what the entrepreneur manager manages, how they manage, their effectiveness and the effect they have as a manager not by the particular tasks they undertake.

1.6.1.5 Wealth of the Entrepreneur

Wealth is money and anything that money can buy. It includes money, knowledge and assets of the entrepreneur.

Who Benefits from the entrepreneur's Wealth?

No entrepreneur works in a vacuum. The venture they create touches the lives of many other people. To drive his/her venture forward, the entrepreneur calls up on the support of a number of different groups. In return for their support these groups expect to be rewarded from the success of the venture. Peoples who have a part to play in the entrepreneurial venture generally are called stakeholder. The stakeholder groups are; employees, investor, supplier, customer, the local community and government. Let us look at the benefits of each stakeholder.

- 1) **Employees:** They contribute physical and mental labor to the business. Success of the entrepreneurial venture depends on their effort and motivation. Therefore, they are rewarded with:
 - C. Money – their wage or salary
 - D. The possibility of owning a part of the firm through share schemes.
 - E. A stage of which they can develop social relationships.
 - F. The possibility of personal development.
- 2 **Investors:** These are the peoples who provide the entrepreneur with the necessary money to start the venture and keep it running. There are two main sorts of investors: stockholders and

lenders. Stockholders are those who buy the stock of the company and are true owners of the firm. The actual return of the stockholders varies depending on how the business performs. Lenders, on the other hand, are people who offer money to the venture on the basis of it being a loan. They do not actually own a part of the firm and their return is independent of the businesses performance. They also take priority for payment over shareholders and face lower level of risk than the stockholders.

- 3 **Supplier:** They are the individuals and organizations who provide the business with the materials, productive assets and information it needs to produce its output. They are paid for providing these inputs.
- 4 **Customers:** Customers may need to make an investment in using a particular supplier. Changing supplier may involve switching costs and supplier, risk of quality and expenses incurred in changing over to new inputs. The entrepreneur may reward customers by offering quality products, fair prices, regular and consistency of supply, loan arrangement etc.
- 5 **The local community:** Business has physical locations. The way they operate may affect the people who live and other businesses which operate nearby.

A business has a number of responsibilities, which may be defined or not in national laws, to this local community. Such as:

- A. Not polluting their shared environment
 - B. Contributing and sponsoring local development activities
 - C. Contribution for political and cultural stabilities and economic improvements
 - D. Acting in an ethical way.
6. **Government:** The responsibility of government is to ensure that businesses can operate in an environment which has political and economic stability. In addition, it provides central services such as education and health-care. These activities cost money to provide.

Therefore, government should be rewarded for its services. Hence, government taxes individuals and businesses.

1.6.2 Entrepreneurship and Environment

Business environment refers to the factors external to a business enterprise which influence its operations and determine its effectiveness. Business environment may be healthy or unhealthy. Healthy business environment means the conditions are favorable to the growth of business whereas

unhealthy environment implies conditions hostile or unfavorable to business operations. Business and its environment interact with each other. Economic system and other conditions in the environment determine the success of business enterprises. The firm and its management have to adjust to the conditions prevalent around it. However, business enterprises try to influence and shape the environment. Successful working of business concerns improves the economic and social conditions in the country.

No business concern can ignore the environment around it except at its own peril. “The penalty of environmental disregard is heavy. It not only reduces profit margins and makes opportunities for expansion slip, but it also arouses social hostility and makes social environment growingly inhospitable to business operations.”

A study of business environment offers the following benefits:

- ☐ It provides information about environment which is essential for successful operation of business firms.
- ☐ It opens up fresh avenues for the expansion of new entrepreneurial operations. The entrepreneurs may come forward with new ideas and with new ventures when they find environment suitable to their enterprises.
- ☐ Knowledge about changing environment enables businessmen to adopt a dynamic approach and maintain harmony of business operations with the environment.
- ☐ By studying the environment entrepreneurs can make it hospitable to the growth of business and thereby earn popular support.

Thus, the entrepreneur should continuously study the nature of environment and its influence on business. However, mere study is not enough. Attempts must be made to influence the environment in order to make it congenial and favorable to entrepreneurial activities. The most successful entrepreneur is one who not only adjusts to the environment but also modifies the environment to suit his requirements through the direct and indirect influences he can exercise over the system.

1.6.2.1 Phases of Business Environment

Business environment may be classified into two broad categories; namely external; and internal environment

A) External Environment

It is the environment which is external to the business and hardly to influence independently. The following are the components of external environment:

i) Economic Environment

Economic environment is of multidimensional nature. It consists of the structure of the economy, the industrial, agricultural, trade and transport policies of the country, the growth and pattern of national income and its distribution, the conditions prevailing in industrial, agricultural and other sectors, the position relating to balance of trade and balance of payments, and other miscellaneous conditions of the economy. There is a close relationship between a business firm and the economic environment around it. The success of a business enterprise depends considerably upon the State and growth of the economy.

ii) Legal Environment

Business must function within the framework of legal structure. Therefore, an adequate knowledge of laws and rules is necessary for efficient managerial performance. When new laws are made and controls exercised through legal enactments, the first reaction of the business community is to oppose them and disobey them. Management should try to understand what should be the right laws and strictly obey them when so made. In addition, it can influence the government to change and improve the law and make it useful to the business community.

There are several business laws in our country. A working knowledge of these laws is very helpful for the entrepreneur. Such knowledge will keep them away from innocent breaches and resultant penalties. Some laws differ from region to region and amendments are made from time to time. Therefore, the entrepreneur must always keep in touch with those who know the latest position in law. In addition, an entrepreneur should:

- i) Read the books that enlighten on the legal side of business
- ii) Consult government agencies concerned with the implementation of business laws.
- iii) Retain labor law consultants.

iii) Political Environment

In a democratic country, politics cannot be ignored. Managers and entrepreneurs should understand the working of the political system. Such understanding and concern for national problems will help them in the long run in discharging their responsibilities to the satisfaction of the public.

Public opinion is very important and today's public opinion becomes tomorrow's legislation. Businessmen should, therefore, learn to take public opinion into account in the decision-making process. If business does not learn how to deal adequately with public opinion, it will face a disaster. This does not mean that business should surrender itself to public opinion. Rather, it implies intelligent response in order to change wherever necessary and a constructive approach to problems.

iv) Socio-Cultural Environment

It consist the social and cultural norms of a society in a given period of time. The variables that are appraised are values, beliefs, norms, fashions and fads of a particular society. It can help in understanding the level of rigidity/flexibility of a given society towards a new product/service/concept. Traditional culture should be protected in so far as it is not a hindrance to innovation, motivation, and development.

v) Demographic Environment

It assesses the overall population pattern of a given geographical region. It includes variables like age profile, distribution, sex, education profile, income distribution etc. The demographic appraisal can help in identifying the size of target customers.

B) Internal Environment

Internal environment is the environment which is under the control of a given organization. Following are the components of internal environment of a business:

- I. Raw Material:** It assesses the availability of raw material now and in the near future. If the availability of raw material is less now or would be less in future then the entrepreneur should give a serious thought to establishing a venture as the entire system can come to a standstill due to shortage of raw material.
- II. Production/Operation:** It assesses the availability of various machineries, equipment, tools and techniques that would be required for production/operation.
- III. Finance:** It assesses the total requirements of finance in terms start-up expenses, fixed expenses and running expenses. It also indicates the sources of finance that can be approached for funding.
- IV. Human Resource:** It assesses the kind of human resources required and its demand and supply in the market. This further helps in estimating the cost and level of competition in hiring and retaining the human resources.

As stated above, the objective of environmental scanning should be to gather information from as many sources as possible and to maximize this information for enhanced probability of success in the business.

1.6.2.2 Environmental Factors Affecting Entrepreneurship

A complex and varying combination of financial, institutional, cultural and personality factors determines the nature and degree of entrepreneurial activity at any time. The personal backgrounds of the entrepreneurs are determined mainly by the environment in which they are born and brought up

and work. A multitude of environmental factors determine the entrepreneurial spirit among people. The entrepreneurs in turn create impact on the environment. The interaction between the entrepreneur and his environment is an ongoing process. At any given point of time, the entrepreneurs derive meanings from the environment prevailing at that time and try to adapt and/or change the environment to suit their needs.

Some of the environmental factors which hinder entrepreneurial growth are given below:

- ☐ Sudden changes in Government policy.
- ☐ Sudden political upsurge.
- ☐ Outbreak of war or regional conflicts.
- ☐ Political instability or hostile Government attitude towards industry.
- ☐ Excessive red-tapism and corruption among Government agencies.
- ☐ Ideological and social conflicts.
- ☐ Unreliable supply of power, materials, finance, labor and other inputs.
- ☐ Rise in the cost of inputs.
- ☐ Unfavorable market fluctuations.
- ☐ Non-cooperative attitude of banks and financial institutions.

Entrepreneurship is environmentally determined. The most important essential for entrepreneurial growth is the presence of a favorable business environment. A healthy business environment requires active social and cultural behavior of the people, efficient economic conditions, helpful motivating Government policies, etc. When environment mitigates entrepreneurship it must be modified.

1.7 Creativity, Innovation and Entrepreneurship

Creativity, innovation and entrepreneurship, have been recognized as important contributors to a nation's economic growth. These three terminologies are chronologically interrelated and it is very important to look in to them to get their full picture.

1.7.1 Creativity

Creativity is defined as the tendency to generate or recognize ideas, alternatives, or possibilities that may be useful in solving problems, communicating with others, and entertaining ourselves and others. Creativity is the ability to come up with new idea and to identify new and different ways of looking at a problem and opportunities.

It is a process of assembling ideas by recombining elements already known but wrongly assumed to be unrelated to each other. This definition has several key elements that are worth considering:

- Process: creativity is a process (implying among other things, that it is more like a skill than an attitude, and that you can get better at it with practice)
- Ideas: creativity results in ideas that have potential value.
- Recombining: the creative process is one of putting things together in unexpected ways. In order to be creative, you need to be able to view things in new ways or from a different perspective. Among other things, you need to be able to generate new possibilities or new alternatives. Tests of creativity measure not only the number of alternatives that people can generate but the uniqueness of those alternatives. The ability to generate alternatives or to see things uniquely does not occur by chance; it is linked to other, more fundamental qualities of thinking, such as flexibility, tolerance of ambiguity or unpredictability, and the enjoyment of things heretofore unknown.

Thus, creativity is the development of ideas about products, practices, services, or procedures that are novel and potentially useful to the organization.

1.7.1.1 Steps in the Creative Process

Step1: Opportunity or problem Recognition: A person discovers that a new opportunity exists or a problem needs resolution.

Step2: Immersion: the individual concentrates on the problem and becomes immersed in it. He or she will recall and collect information that seems relevant, dreaming up alternatives without refining or evaluating them.

Step 3: Incubation: the person keeps the assembled information in mind for a while. He or she does not appear to be working on the problem actively; however, the subconscious mind is still engaged. While the information is simmering it is being arranged into meaningful new patterns.

Step 4: Insight: the problem-conquering solution flashes into the person's mind at an unexpected time, such as on the verge of sleep, during a shower, or while running. Insight is also called the Aha! Experience.

Step 5: Verification and Application: the individual sets out to prove that the creative solution has merit. Verification procedures include gathering supporting evidence, using logical persuasion, and experimenting with new ideas.

1.7.1.2 Barriers to Creativity

Be aware that there are numerous barriers to creativity, including:

1. searching for the one „right“ answer
2. focusing on being logical
3. blindly following the rules
4. constantly being practical
5. viewing play as frivolous
6. becoming overly specialized
7. avoiding ambiguity
8. fearing looking foolish
9. fearing mistakes and failure
10. believing that „I“m not creative

1.7. 2 Innovation

Innovation lies at the heart of the entrepreneurial process and is a means to the exploitation of opportunity. It is the implementation of new idea at the individual, group or organizational level.

Innovation is a process of intentional change made to rate value by meeting opportunity and seeking advantage.

There are four distinct types of innovation, these are as follows:

- ☐ Invention - described as the creation of a new product, service or process
- ☐ Extension - the expansion of a product, service or process
- ☐ Duplication - defined as replication of an already existing product, service or process
- ☐ Synthesis - the combination of existing concepts and factors into a new formulation

1.7.2.1. The Innovation Process

1. **Analytical planning:** carefully identifying the product or service features, design as well as the resources that will be needed.
2. **Resources organization:** obtaining the required resources, materials, technology, human or capital resources
3. **Implementation:** applying the resources in order to accomplish the plans
4. **Commercial application:** the provision of values to customers, reward employees and satisfy the stakeholders.

□ **Areas of Innovation**

The following are some of the major areas in which valuable innovation might be made.

- A. New product:** A new product can be developed through new or existing technology. The new product may offer a radically new way of doing something or it may simply be an improvement on an existing item. The new product must offer the customer an advantage if it is to be successful.
- B. New Services:** A service is an act which is offered to undertake a particular task or solve a particular problem.
- C. New Production Techniques:** Innovation can be made in the way in which a product is to be manufactured. A new production technique should allow the end user to obtain the product at a lower cost, or a product of higher quality or better service in the supply of the product.
- D. New Way of Delivering the Product or Service to the Customer:** Customer can only use product/service they can access. A common innovation is to take a more direct routine by cutting out distributors or middlemen.
- E. New Operating Practices:** As with innovations in the production of physical products, innovation in service delivery must address customers need and offer them improved benefits, for example easier access to the service, a higher quality service, a more consistent service, a faster or less time consuming service etc.
- F. New Means of Informing the Customer about the Product:** People will only use a product or service if they know about it. Demand will not exist if the offering is not properly promoted to them. Promotion consists of two parts; a message what is said and a means – the route by which that message is delivered.
- G. New Means of Managing Relationship within the Organization:** Any organization has a wide variety of communication channels running through it. The performance of the organization will depend to a great extent on the effectiveness of its internal communication channels. These communication channels are guided by the organization's structure.
- H. New Ways of Managing Relationships between Organizations:** Organizations sit in a complex web of relationships to each other. The way they communicate and relate to each other is very important.

1.7.3 From Creativity to Entrepreneurship

Creativity is the ability to develop new ideas and to discover new ways of looking at problems and opportunities. **Innovation** is the ability to apply creative solution to those problems and opportunities in order to enhance people's lives or to enrich society.

Entrepreneurship = creativity + innovation.



Fig 1.2: Flow of Creativity, Innovation and Entrepreneurship

Chapter Summary

In this chapter a brief discussion is made on the term entrepreneurship and entrepreneur. The different roles and tasks of the entrepreneurs are also part of the discussion. The word entrepreneurship is defined as a process that involves creation of something different and better with values to target customers. Here the entrepreneur is someone who will undertake the activities of creating something different and commercialize it in a given business environment. The three forms of entrepreneurship are also distinguished as individual entrepreneurship, intrapreneurship and organizational entrepreneurship. A person to become an entrepreneur needs to possess entrepreneurial mindset through having qualities of successful entrepreneurs and entrepreneurial skills, and he/she also to understand and scan entrepreneurial environment. Now when the entrepreneur carries out the entrepreneurial process he/she will be able and expected to create wealth for him/herself and for others as well. For this the entrepreneur should have general management and people management skills. Finally, the entrepreneur should play active role in the economic development through improving in per capita income, generating of employment opportunities, inspiring others towards entrepreneurship, balancing regional development, enhancing the number of enterprise, providing diversity in firms, assuring economic independence, combining of economic factors, providing market efficiency, by accepting risk and maximizing investors return.

Review Questions

- 1) Which one of the following critical contributions by entrepreneurs is the cumulative outcome?
 - A. Creativity and innovation
 - B. Rise up in research and development effectiveness
 - C. Job creation and reduction of poverty
 - D. Increment of productivity and new industry formation
 - E. Progression of economic growth
- 2) There is no concise and universally accepted definition of entrepreneurship and entrepreneurs. The concept varies because of the following except:
 - A. Variation of country
 - B. Difference in time/ period gaps
 - C. Economic development differences
 - D. Thoughts and perceptions of individuals and scholars
 - E. Unavailability of business opportunities
- 3) Entrepreneur for psychologists is a person who _____.
 - A. Is creative destructor
 - B. Sees changes as an opportunity
 - C. Is driven by behavioral forces
 - D. Finds better ways to utilize resources and reduce waste
 - E. Makes something from nothing
- 4) According to Robert Hisrich's definition the main focus of entrepreneurship is:
 - A. Creating something differently with value resources freely
 - B. Being gambler to satisfy one's own personal need than calculated risk- taker.
 - C. Assumption of free from any accompanying risks of the process
 - D. Is conducted for the purpose of receiving monetary rewards than personal satisfaction
 - E. None of the above
- 5) Which of the following statements is true?
 - A) The creative mind cannot be acquired and developed
 - B) People can be taught to be creative solution provider
 - C) Creativity has nothing to do with learning like change of behavior
 - D) People are born with creativity and can do nothing to change their level of creativity
 - E) Creativity is the final step in entrepreneurial activity

- 6) Entrepreneurship **can best** be described as:
- A. A process that requires setting up of small business
 - B. Taking sever risk in a business context
 - C. Having a strong vision that benefit the matured firm
 - D. A process involving creativity, innovation and value creation
 - E. Generation of new jobs for unemployed forces
- 7) Entrepreneurs are highly motivated :
- A. To be independent
 - B. To generate a volume of money
 - C. To be a boss for the purpose of commanding others as one's personal values
 - D. To be risk taker regardless of its severity
 - E. To forget the burden of unemployment
- 8) Which one is true about entrepreneurship?
- A. Successful entrepreneurs assume that their success is largely determined by luck
 - B. Success goes with entrepreneurs having high internal locus of control
 - C. Entrepreneurship is an inborn personality trait or an art that you either have it or you don't
 - D. A & B
- 9) ____ entrepreneur is an individual motivated by psychological and economic reward
- A. Pure entrepreneur
 - B. Technical entrepreneur
 - C. Corporate entrepreneur
 - D. Professional entrepreneur
- 10) In the beginning entrepreneurs are advised to accept
- A. Higher level of risk
 - B. Moderate risk
 - C. Low level risk
 - D. Avoid risk
- 11) If someone who is unemployed starts his own business what do you think the drive behind?
- A. Opportunity
 - B. Independence
 - C. Need for achievement
 - D. Necessity
12. Among the following one ***is not*** a „pull-influence“
- A. Employment opportunity
 - B. Desire to exploit an opportunity
 - C. Turning hobby or previous work experience in to a business

D. Financial incentive

E. None

13. _____ is defined as a system of beliefs about how one conducts an enterprise.

A. Business secrecy

D.

Entrepreneurial team

B. Business ideology

E.

None.

C. Business making

14. _____ Entrepreneur demonstrate his/her innovative skill in organizing and managing a corporate undertaking.

a. Industrial entrepreneur c. Business entrepreneur b. Pure entrepreneur d.

Corporate entrepreneur

15. Give at least two definitions for entrepreneurship and two for entrepreneur.

.....
.....

16. Who are the potential candidates for entrepreneurship?

.....
.....

17. Identify any five qualities of a successful entrepreneur

.....
.....

18. Some people argue that “the only beneficiary of the entrepreneurial wealth is the entrepreneur him/herself” Do you agree? Why or why not?

.....
.....

19. How do you define creativity, innovation? Relate it with entrepreneurship.

.....
.....

20. Discuss any four possible areas for innovation

.....
.....

21. How do you relate entrepreneurship and environment?

.....
.....

CHAPTER TWO

SMALL BUSINESS

Introduction

Dear learners, Small businesses are the vital component of any nation's economy. Most small scale industries have a low capital intensity and high potential for employment generation. They possess location flexibility which serves as an effective instrument for achieving a wide dispersal of industries. Small scale units serve as a means of bringing forth indigenous entrepreneurship and saving lying dormant, particularly in semi-urban and rural areas. The small scale sector has a high potential for employment, dispersal of industries, promoting entrepreneurship and earning foreign exchange to the country.

According to Small Business Administration, a small business is one that does not dominate its industry has less than \$10 million in annual sales, and has fewer than 1000 employees. In the USA, the manufacturing firm is officially a small business for government procurement purposes, if it is not dominant in its field of operations and if it has fewer than 500 employees, or if it is certified as small by the Small Business Administration for purposes fewer than 250 employees, depending on the size and the standard set for different industries.

Chapter objectives

Dear learner, this chapter is meant to acquaint you with the basic concepts of small business management. Thus, after going through this lesson you should be able to:

- Understand general concepts of small business
- Know economic, social, and economic contribution of small business enterprise
- Identify small business failure factors
- Know how to set small business venture
- Scan the business environment in terms of the entrepreneurial opportunities and Threats
- Use your creativity and innovativeness in identifying business ideas
- Tap other sources for idea generation.

2.1 Definition

Defining small business is not an easy as it looks; we can have different definitions depending on the size of the industry we are talking about, the purpose of the definition, and the country the definition is applicable to. The definition of small enterprises varies from one country to another. In most of the countries of the world, the criterion for defining a small enterprise is related to the size of employment. For instance, in USA, small business is one which has employment of less than 500 people. In U.K, it is less than 20 skilled workers, in Germany less than 300 workers, in Sweden less than 50 and Italy less than 500. The approaches writers use in defining small business include:

- iv) **By size criteria:** Taking size in consideration the following could be used relatively to describe/define small business;
 - ☐ number of workers involved in the business
 - ☐ Sales volume
 - ☐ Capital of start up

The specific number of employees, sales volume or asset size and the amount of capital varies from nation to nation. For instance, according to the USA small business administration (SBA), the number of employees in the business is usually fewer than 100. However, this is not the case in our country.

- ii) **By economic control criteria:** This criterion covers the economic role of the business like how much asset involves, how much employment chance it provides. Again, this depends on the law of the nation.
 - ☐ **Market share:** The small business by very nature is not large enough to enable it to influence the price of the national quantities of goods sold to any significant extent. In other words, any form of small business has very limited market share even that sometimes could be insignificant. For example, take a given city and imagine about the market share of a single restaurant.
 - ☐ **Personalized Management:** The owner of any small business plays all most all the business role i.e. from start up to entire management. It implies that the owner actively participates in all aspects of management of the business, in all major decision-making process.
 - ☐ **Independence:** the owner of any small business enterprise has control of the business by himself.

Generally, there is no universally accepted definition of small business. For the sake of our discussion, we adopt the following definition. Small business is a business, which employs less than 100 employees, owned by one or few individuals, with the exception of the marketing function has geographically localized operations, and does not dominate the industry.

The improved definition of MSE from Ethiopian Context

In our country two different definitions of MSE were used so far i.e. the 1998 definition of MSE development strategy, and definition given by CSA. Because of both of them had shortcomings; improved definition for the sector was given based on the gathered experience, by identifying the gaps of the existing definition of MSE, including the size of employee and by taking total asset as criteria and by dividing it in to industry and service sector; and considering the inflation and fluctuation/irregularity of currency.

- A. Under micro enterprise level, industry sub-sectors including manufacturing, construction and mining operating with 5 people including the owner and/or their total asset is not exceeding Birr 100,000 (one hundred thousand).
- B. Under micro enterprise level, service sub-sectors including retailer, transport, hotel and Tourism, ICT and maintenance service operating with 5 persons including the owner of the enterprise and/or the values of total asset is not exceeding Birr 50,000(fifty thousand).
- C. Under small enterprise level, Industrial sub-sectors included manufacturing, construction and mining operating with 6-30 persons and/or with a paid up capital of total asset Birr 100,000(one hundred thousand) and not exceeding Birr 1.5 million.
- D. Under small enterprises level, Service sub-sectors including retailer, transport, hotel and Tourism, ICT and maintenance service operating with 6-30 persons or/and total asset, or a paid up capital is with Birr 50,001 and not exceeding Birr 500,000 are defined officially and used in Ethiopia.

Enterprise Level	Sector	Sub-Sectors	Man power	Total asset
Micro	<i>Service</i>	Retail, Transport, Hotel and Tourism, Recreation, Information Technology and Maintenance	< 5	< 50,000 birr
		<i>Industry</i> Manufacturing Construction Mining	< 5	< 100,000 birr
Small	<i>Service</i>	Retail, Transport, Hotel and Tourism, Recreation, Information Technology and Maintenance	6-30	< 500,000 birr —
		<i>Industry</i> Manufacturing, Construction Mining	6-30	< 1.5 million birr —

Main sectors and sub-sectors that focus area

Manufacturing	Construction	Trade	Service	Urban Agriculture
☐ Textile ☐ Leather ☐ Food ☐ Beverage ☐ Metal works ☐ Wood works ☐ Agro-Processing	☐ Sub-contracting ☐ Building materials ☐ Traditional Mining ☐ Cobble stone ☐ Infrastructure sub contract ☐ restigious Goods	☐ Whole Sale ☐ Retailer ☐ ☐ materials ☐ Supply	☐ Transport service and ☐ Café Restaurants ☐ Store service ☐ Tourism service ☐ Canning/packing ☐ Management ☐ Service ☐ Muicipality ☐ Service ☐ Product design ☐ Maintenance etc.	☐ Modern livestock raring ☐ Bee productio ☐ Poultry ☐ Modern forest development ☐ Vegetables and fruits ☐ Modern irrigain ☐ Animal food processing

Definition of small industry according to Ethiopia ministry of trade and industry

In classifying and defining a business organization, the following questions can be raised.

- ☐ What yardsticks are applied to determine business size?
- ☐ Is independent ownership a critical factor?
- ☐ Is either sales volume or number of employees a logical guide in describing smallness?
- ☐ Can a business be described accurately as small in both manufacturing and retailing sector etc.?

The ministry of trade and industry of the FDRE provides the following definitions

Micro enterprises: are business enterprises found in all sectors of Ethiopian economy with a paid-up capital (fixed assets) of not more than 500,000.

Small enterprises: are business enterprises with a paid up capital of more than 500,000 but not more than birr 2,000,000.

The above definitions are given in accordance with the provisions of the Federal Small and Micro Enterprises Agency.

2.2. Characteristics of small scale industries

1. Capital investment is small.
2. Most have fewer than 10 workers
3. Generally engaged in the production of light consumer goods, processing etc.
4. Located in rural and semi-urban areas
5. All of these firms are privately owned and are organized as sole proprietorship.
6. Fixed assets form the largest component of small units.
7. Most of the funds come from the entrepreneur's savings
8. Small scale industrial activity has been growing at a faster rate even than large scale enterprises.
9. Very few of the small scale industries have grown up to medium and large scale industries.
10. Small scale industries activity is beehive of entrepreneurship.
11. Exploitation of natural resources is another characteristic of small scale industries.
12. Small scale industries are quality conscious.

Having the above definition in mind, small business can be found in different industries. These include:

Retail industry: drug stores, clothing stores, bookstores

Service industry: such as accounting firms, advertising agencies , managerial consultants, barber and beauty shops.

Manufacturing industry: like shoe factories, furniture-manufacturing plants etc.

Activity

□ **What is small business?**

2.3. Special Contribution of Small Business:

Although small business pose a number of challenges to the entrepreneur and have certain limitations, countries' economy cannot do without them. This is because small businesses have special features that make them superior over large ones in certain aspects of business activities. First, let us see the special contribution small businesses make to countries' economy and we will try to see why it is advisable for an individual to start small business when embarking on entrepreneurial venture.

1 Providing job opportunities: this is one way in which small businesses contribute to countries' economy. In fact, in most countries, the number of new job created by small business is significantly higher than created by large business. For example, in the US, 50% of the employment comes from small businesses and each year small business account for about 80% the new jobs created.

2 Introducing innovation: new products, which originate in the research laboratories of big businesses, make a valuable contribution to our standard of living. There is a question, however, as to the relative importance of big businesses in achieving the truly significant innovations.

Usually the research department of big business tends to emphasize the improvement of existing products. Records show that many scientific breakthroughs were originated with independent inventors and small organizations.

3. Stimulating economic competition: Small business by definition is one that does not

dominate its industry, and competition will be closer to perfection when the market is full of small businesses that cannot exert a significant impact on the market price and supply when operating individually.

4. Aiding big business: the fact that some functions are more expertly performed by small businesses enables small businesses to contribute to the success of larger ones. Especially there are two types of business activities, which are performed by small businesses more economically and effectively.

- 1) **The distribution function:** Few large manufacturers of expensive consumer products find it desirable to own wholesale and retail outlets.
 - 2) **Supply function:** Most small businesses act as suppliers, and sub-contractor for large firms.
- 5. Producing goods and services:** we depend highly on small businesses for the provision of most goods and services we need in our lives. In fact, if it was not for small business, we would have not been able to find the goods and services we need at time we need them, in a convenient place, and at the quantity we prefer.

In addition to the above general advantages small businesses offer to countries' economy, they have certain benefits to the individual entrepreneur. These include:

- ☐ Small business requires less time, energy, and financial resource to establish.
- ☐ They also provide the entrepreneur with greater autonomy, and independency, - because the money needed to start small businesses is relatively small; the entrepreneur can raise most of it by him or herself without relinquishing significant ownership interest and control.
- ☐ In addition to these, small businesses help the entrepreneur develop his skill in running his organizations as it has different kinds of activities concerning the business. These include business planning, investment and finance, customer relation, personnel, and expected to perform human resources, cash control and bookkeeping, inventory control, purchasing, marketing and sales, and leadership.

2.4. Risks and Causes of Failure Associated with Small Business

Although many new small businesses are established in most countries, the success rate is minimal. This can be attributed to many factors, which can generally be classified into two categories: external and personal factors of failure.

Economic business cycles, fluctuating interest rates, interrupted supplies, labor market, inflation, government regulations, and unstable financial markets are some of the external factors that might bring about small business failures. Although all businesses/small/big are subject to this risk, their effect on small businesses is far more serious than any other businesses. This is because the resources a small business owner controls are very limited which makes it very difficult to deal with these situations.

On the other hand, there are certain problems that can be attributed to personal weakness and limitations of the entrepreneur. These include:

- **Inexperience:** too often, entrepreneurs launch their enterprises without having sufficient experiences to succeed. Inexperience can be translated to mean a lack of technical or management insight.
- **Arrogance:** many small businesspersons – particularly inventors and innovative entrepreneurs with new products become egocentrically engrossed in their ventures. They become consumed with their own brilliance, convinced, beyond reason (often without market research) that their bright idea will change the world-it has to see! Their arrogance will not allow them to take advice from others.
- **Mismanagement:** humble entrepreneurs steeped in experience can still go under simply mismanagement of resources; they simply make bad decisions in critical situations. These may include:
 - **Over investment on fixed assets:** when starting and expanding a business, it is tempting to buy facilities and equipments rather than lease or subcontract. Everyone likes to own assets, but greater investment on fixed assets means less flexibility to adjust to adverse conditions.
 - **Poor inventory control:** purchasing too much inventory increases the risk of low

turnover and obsolescence. Having too little inventory undermines customer satisfaction and sales. Buying the wrong inventory, or buying at the wrong time, evaporates cash. In each scenario, the business ties up high-powered cash in non-earning assets, and the inventory items can rarely be disposed of more than a fraction of their costs in an emergency. The result is that a business "purchases" itself in to insolvency.

- **Poor financial control:** Because of poor control over credit sales, poor bookkeeping, and advances and regular payment for inventory purchase, loan payments, lease payments, utility cost, telephone bills, and payroll expenses.
- **Poor business philosophy:** An unfortunate aspect of many business failures is that too often individual owner's priorities get in the way of sound business practices. In the least obtrusive way, entrepreneurs may not be fully committed to the long hours required to make a venture successfully.
- **Lack of planning:** most entrepreneurs frequently underestimate the importance of planning in the business success. However, not planning means not anticipating future problems and challenges and not being prepared for them in advance. This surely leads the entrepreneur into making mistakes and facing problems, which could have easily avoided through sound planning.

2.5. Problems in Ethiopian Small Business

Small –scale industries have not been able to contribute substantially as needed to the economic development particularly because of financial, production, and marketing problems. However, according to World Bank report the case has shown improvement over the last four years.

These problems are still major handicaps to their development. Lack of adequate finance and credit has always been a major problem in Ethiopian small businesses. Small-scale units do not have easy access to the capital market because they mostly are organized on proprietary partnership basis and are of very small size. They do not have access to industrial sources of finance partly because of their size and partly because of the fact that their surpluses that can be utilized to repay loans are negligible. Because of their size and partly because of their limited profit, they search for funds for investment purpose. Consequently, they approach moneylenders who charge high rate of interest and hence small enterprises continue to be

financially weak.

Small-scale enterprises find it difficult to get raw materials of good quality and cheaper rates in the field of production. Very often, they do not get raw material in time. As a result, these enterprises very often fail to produce goods in requested quantities and of good quality of a low cost. Furthermore, the techniques of production, which these enterprises have adopted, are usually out dated. Because of their poor financial position they are not able to buy new equipment, consequently their productivity suffers. Besides, many small business enterprises are suffering with the problem of marketing their products.

2.7. Merits and demerits of small business

Some firms operate in all industries. Nevertheless, they differ greatly in their nature and importance from industry to industry. Currently in Ethiopia, one can clearly observe that the desire for individuals to own and operate their own small business is growing. Small business engagement may provide numerous benefits. It also helps to develop professional competency that might lead to larger businesses. The following are more common advantages of owning a small business.

- a. *Independency:*** most small business owners enjoy being their own boss; they like the freedom to do things their way. Although often a great deal of responsibility is associated with this independency, they are willing to assume it.
- b. *Financial opportunity:*** The possible financial opportunity obtained from small business is the main reason that let the owner to endure all possible challenges and pains. Many small business owners make more money running their own company than they would be working for someone else.
- c. *Job security:*** When one owns the business, job security is insured. The individual can work as long as he or she wants. No mandatory retirement exists.
- d. *Community service:*** Sometimes an individual will realize that a particular good or service is not available. If the person has reason to believe the public will pay for such output, he or she will start a company to provide it.
- e. *To practice challenge:*** Starting and properly managing small business has its own challenges. Research reveals that most successful small business owners like to feel they have a chance to succeed and a chance to fail but one thing is certain: the final

outcome depends heavily on them; they want to win or lose their own abilities. This challenge gives them psychological satisfaction. Although there several advantages associated to small business, it is not without certain demerits. Thus, it should be recognized that some drawbacks to owning small business exist.

The following could be some of the demerits.

- **Competition:** Comparatively the level of risk, start-up challenges, and requirement for small business give a room for competitors to enter into small businesses. Even in your locality, you can observe the movement one might identify an opportunity to open any small business, sooner he/she finds some other similar business opens just at their business sides.
- **Sales fluctuation:** sales fluctuations could be a possible challenge associated with small business. This could occur due to change in the market or increasing numbers of competitors. This in turn might lead to financial losses.
- **Increased Responsibilities:** Small business owners face many responsibilities due to the nature of the business i.e. because owners not only have to make more decisions on major matters but also have to become knowledgeable in many different areas.
- **Risk of failure:** The ultimate risk the small business owner- managers face is failure, usually with a loss of most, if not all, of the money invested in the enterprise. All owners face this risk, and despite experience and business knowledge, money fails because of factors beyond their control. For example, a major recession hits most small businesses very hard. Meanwhile, despite precautions, every year some companies are forced into bankruptcy because insiders embezzle their funds who systematically drain their financial resources. In addition, disasters can strike, such as the unexpected flood etc. In each of these cases, the company may force to close its doors. In most instances, however, poor management causes failure.
- **Employee relations:** if family members own the business and there are closer, relatives are working along with many few other non-relative workers, the employee relation could be sometimes challenging.

Besides, friction among workers who do not like each other, it requires the owner to resolve

the conflicts by either getting the employees to put aside their personal differences or by firing one or more of them. Another common problem is job assignment, who will do what? The owner must be careful not to overload one person with work while another does virtually anything. Financial compensation is also an issue. How much each person should be paid? When should raises be given? In short, the business growth requires addressing more employee relations issues.

Activity

- ☐ *What are the risks of small business?*
- ☐ *Write the special contribution of small business?*
- ☐ *What are the types of small business?*

2.8. Setting Small Businesses

2.8.1. What is a basic business idea?

An entrepreneur should keep in view of future long term goals. The long term thinking is called **basic business idea**. An entrepreneur perceives an opportunity for marketing a product or service. Then she/he establishes a business unit on the basis of her/his perception. Finally, she/he manages her/his enterprise expanding, growing or diversifying over a period of time. The basic business idea, which facilitates a choice of the products at different stages of the project, allows for diversification and expansion. The entrepreneur should monitor the dynamic business environment and select basic business idea that;

1. Would generate quick returns and,
2. Would permit changes in the products.

The general business atmosphere guides the choice of basic business idea. A basic business idea results from the identification of business opportunities in the market. To be successful in business, the entrepreneur should carry out SWOT analysis, be sensitive to the market changes, monitor the demand and supply, study consumer behavior and choose the basic business idea.

2.8.2. Steps in Setting up Businesses

In order to establish an entrepreneurial system, an entrepreneur needs to take the following steps:

1. Search for business ideas.
2. Process the ideas.
3. Select the best idea.
4. Assemble the necessary input resources.
5. Establish the enterprise.

1). Search for business idea

The task of promotion begins with the search for a suitable business idea or opportunity. The idea may be generated from various sources e.g. success story of a friend or relative, demand for certain projects, chances of producing a substitute for an imported article, visits to trade fairs and exhibitions, study of project profiles and industrial potential surveys, meeting with government agencies etc. The idea may relate to the starting of a new business or to take over of an existing enterprise. The idea should be sound and workable. It should yield a reasonable return on investment. The promoter has to be imaginative and foresighted to discover a business idea.

Sources of Business ideas

As entrepreneurs start up a new business, they could get the idea of business from different sources. There are many possible sources of ideas. Some of the more useful ones are consumers, existing companies; distribution channels, the government and research and development units.

- a. **Work experience:** a significant number of entrepreneurs have acquired a voracious work experience through employment. Research suggests that entry into business after certain level of work experience is a plus to success in business. People working in a particular company will become familiar with the practices and business opportunities perused by their employer company. A closer observation of the gaps the company creates, success factors, complementary areas, supplementary areas, as well as potential markets leads them to think about seizing the opportunities.

- b. **Hobbies:** Most often people consider what they like doing frequently and enjoy, and change such avocations into business opportunities. Many promotion and advertising tycoons, photography and film making, sanitation and environmental cleaning, restaurant and hotel runners, gymnasium owners, bookstore successes, beauty service business owners, agriculturalists, floriculturalists, etc are backed by their hobbies.
- c. **Deliberate search:** Sizeable numbers of people go into business after an extensive market need assessment to identifying demand and supply gaps and future prospects.
- d. **Observation:** observation of the market through personal exposure may give a flash idea of going into business. This may include; observation of customer complaints, understandings of what the people like doing most often, a closer examination of the socio-cultural conditions etc.
- e. **Customers:** - Entrepreneurs are paying increasing attention to what should be the focal point of the idea for a new product or service in the eyes of the customer. This can take the form of monitoring ideas mentioned on an informal basis or formally arranging for consumers to have an opportunity to express their opinions.
- f. **Existing companies:** - Entrepreneurs should also establish a more formal method for monitoring and evaluating the products and services being offered by existing or new companies. Frequently this analysis uncovers ways to improve on these present offerings, resulting in a new venture being formed.
- g. **Distribution channels:** - Members of the distribution channels are also excellent sources for new ideas. Because of their familiarity with the needs of the market channel members frequently have suggestions for completely new products. These channel members can also be a source of help in marketing the new idea once it is developed by the entrepreneur.
- h. **Research and Development units:** - The largest source for new ideas is the entrepreneur's own research and development department, whether this is a more formal endeavor connected with current employment or an informal lab at home. Of course the more formal research and development department is often better equipped to produce successful new product ideas.

- i. **Government:** - New product ideas can come from government regulations. In addition, governments that have patent offices provide a good source of new ideas to entrepreneurs. Although the patents themselves may not be feasible for new product introductions, they can frequently suggest other, more marketable, new product ideas.

Activity

- ☐ Are you clear with the role of government to be a source of new business ideas? What about distribution channel members?

Methods for Generating Ideas

- ☐ **Brainstorming:** -It is the most well-known and widely used technique. This method is based on the fact that people can be stimulated to greater creativity by meeting with others and participating in organized group experience.

The entrepreneur can gather a group of people to discuss and generate new ideas. When using this method, the following four overall rules need to be followed: -

- ☐ No criticism is allowed - no negative comments
- ☐ Freewheeling is encouraged – the wild the idea the better
- ☐ Quantity of idea is desired – the greater the number the more likelihood of useful ideas emerging.
- ☐ Combinations and improvements of ideas are encouraged – ideas of others ☐ can be used to produce still another new idea.

- ☐ **Heuristics:** - It is an integral part of creativity. The heuristics entrepreneurs call up on to generate business ideas can be seen to involve two types.

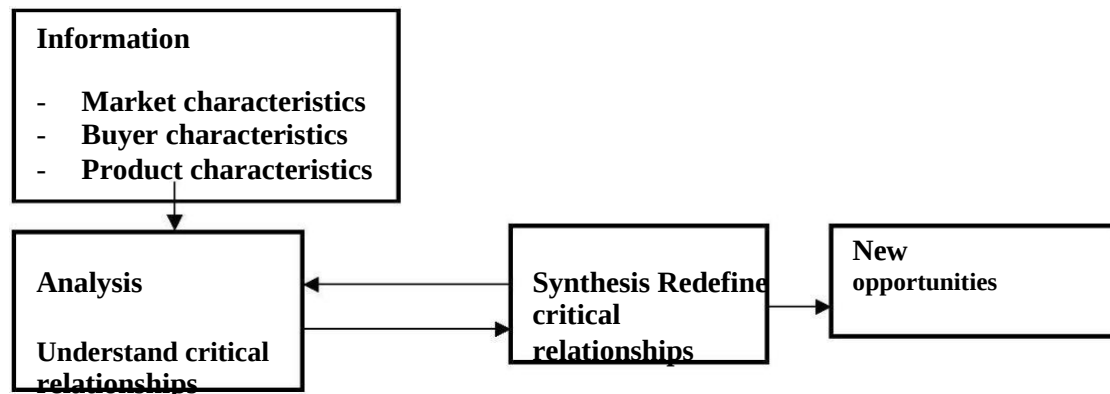
1st - **Analysis heuristics:** - These are the cognitive strategies entrepreneurs adopt in order to gain and integrate new information about the world, to understand the patterns in this information and to spot market gaps.

2nd – **Synthesis heuristics:** - Synthesis involves using a cognitive strategy to bring the ideas developed from analysis back together again in a new and creative way generating a new

perspective on customer needs and how they might be addressed.

Analysis is about spotting opportunities; synthesis is about creating innovations that might exploit those opportunities. These two sets of heuristics lie at the center of a process with information as an input and new business opportunities as an output.

Fig 4.1 Heuristic discovery



- **Customer Proposal:** - A new opportunity may be identified by a customer on the basis of recognition of their own needs. Customer proposals take a variety of forms. At their simplest they are informal suggestions of the “wouldn’t it be great if---”type. Alternatively, they can take the form of a very detailed and formal brief.
- **Creative groups:** - An entrepreneur does not have to rely on his or her own creativity. The best entrepreneurs are active in facilitating and harnessing the creativity of other people too. A creative group consists of a small number of potential customers or product experts who are encouraged to think about their needs in a particular market area and consider how these needs might be better served. The customers may be the ultimate consumers of the product or service or they may be industrial buyers.
- **Market Mapping:** - It is a formal technique which involves identifying the dimensions defining a product category. These dimensions are based on the features of the product category. The features will differ depending on the type of product, but indicators like price, quality and performance are quite common. The characteristics of buyers may also be used to provide a more detailed mapping. A map is created of the market by using the feature buyer dimensions as co-ordinates.

- **Features Stretching:** - Innovation involves offering something new. This means looking for ways in which changes might be made. It involves identifying the principal factors which define a particular product or service and then seeing what happens if they are changed in some way. The trick is to test each feature with a range of suitable adjectives such as: bigger, stronger, faster, more often more fun and so on and see what results from such testing.
- **Product blending:** - This technique involves identifying the features which define particular products. Instead of just changing individual features, new products are created by blending together features from different products or services. This technique is often used in conjunction with features stretching. Both features stretching and features blending make good team exercises and can prove to be quite good fun.
- **Focus group:** - This method consists of a moderator leading a group of people through an open, in-depth discussion rather than simply asking questions to solicit participative response. The moderator focuses the discussion of the group on the new product area in either a directive or a non directive manner. In addition to generating idea, it is an excellent method for initially screening ideas and concepts.
- **Problem Inventory Analysis :** It generates ideas analogous to focus groups. However, instead of generating new ideas themselves, consumers are provided with a list of problems form a general product category. They are then asked to identify and discuss products in this category that have the particular problem. This method is often very effective as it is easier to relate known products to suggested problems and arrive at a new product idea than to generate an ending new product idea by itself. This approach is also an excellent way to test a new product idea. Results from product inventory analysis must be carefully evaluated as they may not actually reflect a new business opportunity. To insure the best results, problem inventory analysis should be used primarily to identify product ideas for further in-depth study to determine their importance to consumers.
- **Reverse Brainstorming:** It is similar to brainstorming, except that criticism is allowed. The technique is based on finding fault by assessing the question “In how many ways can this idea fail?” Care must be taken to maintain the group’s morale. The process most often involves the identification of everything wrong with an idea and then a discussion of ways

to overcome these faults.

- **Synoptic:** It is a creative process that forces individuals to solve problems through one of four mechanisms of analogy – personal, direct, symbolic and fantasy.

A group works through two steps.

1st – to make the strange familiar

This involves, through generalizations or models, putting the problem into a reality acceptable or familiar perspective, thereby eliminating the strangeness. Once the strangeness is eliminated, participants engage in the second step.

2nd – making the familiar strange, resulting in a novel, unique solution being developed.

- **Gordon Method:** The Gordon method, analyzes many other creative problem-solving techniques, begins with group members not knowing the exact nature of the problem. This ensures that the solution is not concluded by preconceived ideas and habit patterns. It follows the following steps:
 - The entrepreneur starts by mentioning a very general concept to the problem
 - The group responds by expressing a number of ideas
 - Then a concept is developed, followed by related concepts through guidance by the entrepreneur.
 - Then the actual problem is revealed, enabling the group to make suggestions for implementation or refinement of the final suggestion.
- **Check List Method:** A new idea is developed through a list of related issues or suggestions. The entrepreneur can use the list of questions or statements to guide the direction of developing entirely new ideas or concentrating on specific “idea” area.
- **Free Association:** The technique is useful in developing an entirely new attitude to a problem. First a word or phrase related to the problem is written down, then another and another, with each new word attempting to add something new to the group of ideas or going thought processes, thereby creating a chain of ideas.

- **Forced Relationships:** A forced relationship is another technique that asks questioning about objects or ideas in an effort to develop a new idea from the resulting new combination.

The new concept is developed through a five-step process.

1. Isolate the elements of the problem
2. Find the relationships among these elements
3. Record the relationships in an organized fashion
4. Analyze the record of relationships to find ideas or patterns
5. Develop new ideas from these patterns.

- **Collective Note Book Method:** A notebook is prepared that includes a statement of the problem, blank pages and any pertinent background data. The entrepreneur then considers the problem and its possible solution, recording resulting ideas several times a day. At the end of the month, a list of the best ideas is developed, along with any suggestions. This technique can also be used with a group of individuals who record their ideas, giving their notebooks to a central coordinator who synthesizes the data and summarizes all the material. The summary becomes the topic of a final creative discussion by the group.
- **Heuristics Analyze-Synthesize:** It relies on the entrepreneur's ability to discover through a progression of thoughts; insights and learning. Heuristics is probably used more than imagined, simply because entrepreneurs frequently must settle for an estimated outcome of a decision rather than an assured certainty. One specific heuristic approach is called the heuristic ideation technique. This involves locating all relevant concepts that could be associated with a given product area and generating a set of all possible combinations of ideas.
- **Scientific Method:** It consists of principles and processes, conducting observations and experiments and validating the hypothesis used in any rigorous investigation. The approach involves the entrepreneur defining the problem, analyzing the problem, gathering and analyzing data developing and testing potential solutions and choosing the best solution.
- **Value Analysis:** It develops methods for maximizing value to the entrepreneur and the

new venture. To maximize value, questions are developed such as “can this part is of lesser quality? Since it isn’t a critical area for problems” To implement a value analysis procedure, regularly scheduled times are established to develop, evaluate and refine ideas.

- **Attribute Listing:** It is an idea finding technique that requires the entrepreneur list the attributes of an item or problem and then looks at each from a variety of viewpoints. Through this process, originally unrelated objects are brought together to form a new combination and possible new uses that better satisfy a need.
- **Matrix Charting :** Matrix charting is a systematic method for searching new opportunities by listing important elements for the product area along the two axes of the chart and then asking questions regarding each of these elements. The answers are recorded in the relevant boxes of the matrix. Example questions that can elicit creative new product ideas include:
 - o For what purpose can it be used for?
 - o When can it be used?
 - o Where can it be used?
 - o How can it be used? o
 - Who can use it?
- **Big Dream Approach:** The entrepreneur dream about a problem and its solution, - thinking big. Every possibility should be recorded and investigated. This should continue until an idea is developed into a workable form.
- **Parameter Analysis:** It involves two aspects: parameter identification and creative synthesis
Parameter identification: -
 - Variable involved in the situation are analyzed to determine their relative importance.
 - These variables become the focus of the investigation, with other variables being set aside.

Creative analysis: -The relationships between parameters that describe the underlying issues are examined. Through an evaluation of the parameters and relationships a solution(s) is developed.

Activity

- ☐ Please explain brainstorming as a tool for generating new ideas.
- ☐ From the idea generation tools discussed above, which of them are best suited for small businesses? What about large firms?

II). Idea processing

Once business ideas are discovered, screening and testing of these ideas is done. The following considerations are significant in the evaluation and testing of business ideas.

i) Technical feasibility

It refers to the possibility of producing the product. Technical feasibility of an idea is judged in terms of availability of necessary technology, machinery and equipment, labor skills and raw materials. The advice and assistance of technical experts may be necessary to judge the technical feasibility of various business ideas.

ii) Commercial viability

A cost-benefit analysis is required to ascertain the profitability of the ideas. An elaborate study of market conditions and prevailing situation is made to assess the viability and prospects of the proposed project. This is known as feasibility study of the project. A number of calculations have to be made about the likely demand, expected sales volume, selling price, cost of production, breakeven point etc. The services of market analysts and financial experts may be necessary for this purpose. In order to judge the workability and profitability of the proposed business, feasibility analysis has to be conducted.

After preliminary evaluation of the idea, the promising idea is subjected to a thorough analysis. Full investigation is carried out in the technical feasibility and economic viability of the proposed project. Financial and managerial feasibility of the idea are tested. After the evaluation of a business idea is completed, the findings are presented in the form of a report known as „feasibility report“ or project report. This report helps in the final selection of the

project. It is also useful for procuring licenses, finance etc from governmental agencies.

III). Idea selection

The feasibility report is analyzed to finally choose the most promising idea. The following considerations influence the selection of idea for a product or service;

- a) Products whose inputs are banned or restricted by the government
- b) Products which can be exported easily and profitably
- c) Products whose demand exceeds their supply so that there exists ready demand.
- d) Products on which the entrepreneur has manufacturing and/or marketing experience.
- e) Parent ancillary relationship i.e. the product is to be manufactured for a parent company.
- f) Products which showed high profitability
- g) Products based on the expansion or diversification plans of existing firms
- h) Products which ensured specific advantages- scale of the industry or the location of the factory or technology of manufacture.
- i) Products favored by the country's industrial/licensing policy.
- j) Products for which incentives and subsidies are available.

While considering these various factors- market, own experience, policy and incentives,- an entrepreneur would generally come across a mix of some encouraging and some discouraging factors with reference to every product.

IV). Assemble the necessary input requirements

Once the promoter is convinced of the feasibility and profitability of the project, he assembles the necessary resources to launch the enterprise. He has to choose partners/collaborators, collect the required finance and acquire land and buildings, plant and machinery, furniture and

fixtures, patents, employees etc. Decisions have to be made about the size, location, layout etc of the enterprise. The form of ownership organization has to be selected. The main inputs required for launching an enterprise are as follows;

a) Information and intelligence

In the turbulent business environment, information and intelligence have become the key input in entrepreneurial success. An entrepreneur requires relevant data on the following aspects:

- ☐ Size and nature of demand for the product or service
- ☐ Volume and sources of supply
- ☐ Price cost volume relationship
- ☐ Sources of raw materials
- ☐ Type and suppliers of technology, machinery and equipment
- ☐ Number and type of personnel required and their resources
- ☐ Amount and sources of funds required for the enterprise
- ☐ Nature and degree of competition
- ☐ Government policies and regulations concerning the industry
- ☐ Export import conditions for the product/service.

b) Finance

A business enterprise requires finance for fixed assets (fixed capital) as well as for current assets (working capital). Once the amount of funds required are established, the entrepreneur has to identify the sources from which the funds are to be raised. He has also to decide the relative proportion between the funds raised from different sources (e.g. shares, debentures, loans etc). This decision is known as the capital structure. It is a very crucial decision because it influences the real worth of the enterprise and the return of the owners. After deciding the capital structure, the funds are raised.

Systems are created for the efficient management and control of working capital and earnings.

C) Personnel

People are the most valuable asset of an enterprise and an entrepreneur has to make the following decisions concerning the personnel:

1. Number of personnel required for management, technical and other positions in the enterprise.
2. Qualifications and experience required in the personnel to perform the jobs effectively
3. Sources of recruitment
4. Procedure and methods of selecting the best candidates
5. Methods of orientation and training.
6. Criteria for evaluating the performance of employees.
7. Policies for the transfer and promotion of staff.
8. Policies and methods of remunerating the personnel.
9. Facilities to be provided for the safety, health, welfare of the staff.
10. Participation of personnel in the management of the enterprise.

V). Establish the enterprise

The form of ownership is to be decided upon and the company formed and registered. Following this, action is directed towards obtaining finance, necessary licenses, and necessary infrastructure is to be taken. This would involve dealing with various government bodies and other institutions like:

- ☐ Financial institutions- for finance
- ☐ Sales tax, Income tax authorities- for respective registration
- ☐ Licensing authority- for obtaining industrial license and licenses for raw material procurement.

- ☐ Municipal Authorities and Electricity- for requisite utilities.
- ☐ Directorate of Industries, Municipal Authorities etc- for land, factory and shed etc

Once all the required authorizations and sanctions have been obtained, action is to be taken for the following;

- ☐ Ordering machineries from suppliers
- ☐ Obtaining utilities like power and water connections
- ☐ Recruitment of staff
- ☐ Arranging supplies of materials
- ☐ Arranging for distribution of the product

The plant is ready for commissioning. Trial run may be made at this stage. Promotion efforts may be made to pave the way for introducing the product. When the first few batches of the product are introduced in the market, information regarding its acceptance is to be gathered. On the basis of feedback obtained, the process/product has to be modified until acceptable output is obtained. Then the unit is ready for commercial production.

Activity

- ☐ ***What are the steps in starting up of a small business enterprise?***

Chapter summary

The definition of small enterprises varies from one country to another. In most of the countries of the world, the criterion for defining a small enterprise is related to the size of employment. Size criteria and economic/control criteria are the two criteria's to define small business.

Providing job opportunities, Introducing innovation, Stimulating economic competition, Aiding big business Producing goods and services are Special Contribution of Small Business

Inexperience, Arrogance, Mismanagement, over investment on fixed assets, Poor inventory

control, Poor financial control, Poor business philosophy, Lack of planning are problems that can be attributed to personal weakness and limitations of the entrepreneur.

Independency, Financial opportunity, Job security, Community service and To practice challenge are some of the merits of small business.

Competition, Sales fluctuation, Increased Responsibilities, Risk of failure and Employee relations are some of the limitations of owning small business.

Small –scale industries have not been able to contribute substantially as needed to the economic development particularly because of financial, production, and marketing problems.

*An entrepreneur should keep in view of future long term goals. The long term thinking is called **basic business idea** which can be generated from different sources and using different methods . An entrepreneur perceives an opportunity for marketing a product or service.*

Project is a system involving the co-ordination of a number of separate department entities through the organization, and which must be completed within prescribed schedules and time constraints.

In order to establish an entrepreneurial system, an entrepreneur needs to Search for business ideas, Process the ideas. Select the best idea, Assemble the necessary input resources, and Establish the enterprise.

Review questions

Choose the best answer

1. One of the following common advantages of owning a small business does not have direct linkage with financial opportunity:
 - A. Practicing challenge
 - B. Getting job security
 - C. Providing community service
 - D. Having independency to do as one's desire
 - E. None of the above
2. Although small business carry a number of challenges and have limitations, countries' economy cannot do without them. This is because of the following **except**:
 - A. They provide relatively high job opportunities than medium and giant companies

- B. They introduce innovation and scientific breakthroughs for big companies once started by independent
 - C. They stimulate economic competition that derive the firms in the industry to perfection
 - D. They help big firms by having backward and forward linkage with them
 - E. They increase unfair competition that fire some competitors from the market
3. Benchmark that covers the economic role of the business in providing chance of employment and asset involvement in defining small business is:
- A. Number employees involved in the business
 - B. Sales volume made
 - C. Economic criteria
 - D. Capital of start up
 - E. Asset size
4. All of the following can be considered as sources of new business idea. except;
- A. Personal observation
 - B. Government
 - C. Trade fairs and exhibitions
 - D. Consumers
 - E. None.
5. . The non-availability of certain goods and services and consequent demand for such goods or services or the availability of certain materials, skills or other inputs is the dominant reason for starting_____.
- A. Techno – economic projects
 - B. Causation – oriented projects
 - C. Factor – intensity oriented projects
 - D. None of the above.
6. In assessing the feasibility and the viability of projects, technical analysis explains;
- A. Preparation of financial statements
 - B. Screening project ideas as well as means of evaluating projects in terms market feasibility
 - C. Establishing whether the project technically feasible or not, and whether it offers a base for the estimation of costs.
 - D. All of the above.
7. Among the following, one is not a sectorial project.
- A. Transportation and communication sector
 - B. Expansion project
 - C. Miscellaneous project
 - D. Social service project
 - E. Agriculture and allied projects

CHAPTER THREE

DEVELOPING A BUSINESS PLAN

Introduction

Dear learners well come to the third chapter of the course. This chapter is designed to provide you with practical, step-by-step instructions on how to prepare your business plan, regardless of whether you are starting a new business or expanding an existing one. The tasks involved in the preparation of the business plan directly correlate to undertaking a detailed feasibility study in order to assess the viability of the business opportunity. The three common constituents of the business plan include:

- ☐ A market analysis,
- ☐ A financial analysis and
- ☐ An organizational plan.

In an attempt to enhance your understanding of the subject matter, we have incorporated samples of what a completed task might look like for a particular business. Do not copy a sample however good it may sound. Use it only to help you understand the purpose of the business plan task. Business plans do not have to be long and elaborate. In many ways the process of thinking through how to go about setting up the business is far more important than the final document and for that reason internal plans can be informal, working documents. Only when they are used to obtain external finance do they need to become a more elaborate „selling document“.

Chapter Objectives

After completing this chapter, students will be able to:

- Identify opportunity in the environment,
- Evaluate the opportunities in the environment,
- Generate business idea,
- Explain the concept of business planning,
- Identify components of business plan,
- Develop business plan,

3.1. Overview of Business Plan

Preparing a business plan is one of the most useful things that you as an entrepreneur or potential entrepreneur, can do. A business plan can serve as both a blue print to follow and as a tool that you can use to get financing. Whether your purpose in preparing a business plan is for operations or financing, or both, you will find that it will result in other important benefits.

It will help you eliminate seat-of-the-pants planning. The systematic planning that goes into the business plan will enable you to make your mistake on paper, rather than in the market place. It will test your resolve about entering or expanding your business, since preparing a comprehensive business plan takes time and effort. Once you have completed this exercise, you will feel more confident about your ability to operate a successful business. Whatever purpose the business plan serves for you, it is important to prepare one, and it is important to do it well. This business plan workbook is designed to provide you with practical, step-by-step instructions on how to prepare your business plan, regardless of whether you are starting a new business or expanding an existing one. You do not need to be an accountant to prepare a good business plan. What is required, though, is a commitment on your part to thoroughly investigate the business concept, decide how you will operate the business, and put this information down in black and white, in a systematic, logical way.

Your task will be to provide various information's about your company, industry, and market that you will operate in. The information that you will obtain will be a result of the research that you do. For that reason, we refer to this first phase of the business plan preparation as the data collection and analysis phase. One purpose of this phase is to gather all the information necessary to make a decision on whether or not to go into a particular business, or to expand an existing business.

A second purpose is to provide you with enough information to decide how best to operate the business. Later in the strategy formulation phase, you will decide how the business will be run (who will manage the business, what prices will be charged, how much advertising will be used, etc). The strategies that you decide upon in the second phase will, to a great extent, be based upon the information that you gather and analyze in the first phase. The third purpose is to compile information which, although of little concern to you, helps readers of your business plan better understand your business. If, for instance, you intend to use your business plan to

get a bank loan, you may want to include a brief history of your business, a description of your products and services, etc.

3.1.1 What is a Business Plan?

A business plan is a written document prepared by the individual entrepreneur or partners that describes the goals and objectives of the business along with steps necessary to achieve those goals. It is also referred to as a proposal, a prospectus, or game plan.

3.2 Importance of Business Planning

Why do you want a business plan? There are many good reasons to create a business plan that many business owners don't know about. Some of them are:

- ☐ ***Set Specific Objectives For Managers:*** Good management requires setting specific objectives and then tracking and following up. It is obvious that many existing businesses manage without a plan. How do they establish what's supposed to happen? In truth, as business grows you want to organize and plan better, and communicate the priorities better. Be strategic. Develop a plan; don't just wing it.
- ☐ ***Share Your Strategy, Priorities and Specific Action Points with Your Spouse, Partner or Significant Other:*** Your business life goes by so quickly: a rush of answering phone calls, putting out fires, etc. Don't the other people in your business life need to know what's supposed to be happening? Don't you want them to know?
- ☐ ***Deal with Displacement:*** Displacement is probably by far the most important practical business concept you've never heard of. It goes like this: "Whatever you do is something else you don't do." Displacement lives at the heart of all small-business strategy. At least most people have never heard of it.
- ☐ ***Hire New People:*** This is another new obligation (a fixed cost) that increases your risk. How will new people help your business grow and prosper? What exactly are they supposed to be doing? The rationale for hiring should be in your business plan.
- ☐ ***Decide Whether You Need New Assets, How Many, and Whether to Buy or Lease***
Them: Use your business plan to help decide what's going to happen in the long term, which should be an important input to the classic make vs. buy. How long will this important purchase last in your plan?

- **Share And Explain Business Objectives with Your Management Team, Employees and New Hires:** Make selected portions of your business plan part of your new employee training.
- **Develop New Business Alliances:** Use your plan to set targets for new alliances and selected portions of your plan to communicate with those alliances.
- **Deal with Professionals:** Share selected highlights or your plans with your attorneys and accountants and if this is relevant to you, consult them.
- **Sell Your Business:** Usually the business plan is a very important part of selling the business. Help buyers understand what you have, what it's worth and why they want it.
- **Valuation of The Business for Formal Transactions:** Valuation is the term for establishing how much your business is worth. Usually that takes a business plan, as well as a professional with experience. The plan tells the valuation expert what your business is doing, when, why and how much that will cost and how much it will produce.
- **Create A New Business:** Use a plan to establish the right steps to starting a new business, including what you need to do, what resources will be required and what you expect to happen.
- **Seek Investment for a Business, whether it's A Startup or Not:** Investors need to see a business plan before they decide whether or not to invest. They'll expect the plan to cover all the main points.
- **Back up A Business Loan Application:** Like investors, lenders want to see the plan and will expect the plan to cover the main points.
- **Grow Your Existing Business:** Establish strategy and allocate resources according to strategic priority. You can find more information about growing your business with a business plan by reading.

3.3 When Business Plans Are Produced?

1. **At The Startup Of A New Business:** After the initial stage of developing ideas and feasibility study are over, a new business may start up through a detailed planning stage of which the main output is the business plan.
2. **Business Purchase:** Buying an existing business does not negate the need for an initial business plan. A detailed plan tests the sensitivity changes to key business variables. This helps to understand the level of risk that are accepted and the likelihood of rewards being available for the buyers.

3. **Ongoing Process:** Ongoing review of progress, against the objectives of either a new business or a small business purchase is important in a dynamic environment. A periodic review with the business plan is required in the constantly changing environment. A business plan should be the live, strategic and technical planning focusing on how a small business responds to the inevitable changes around it.
4. **Major Decisions:** Even if planning is not carried out on a regular basis, it is usually instigated at a time of major change.

3.4 Who Makes The Business Plans?

- A. **Managers:** They are involved in small business planning both as producers and recipients of the plan. The management of a small enterprise is the only people likely to be sufficiently knowledgeable to produce a business plan. Business plans are also written to aid small business managers.
- B. **Owners:** The managers of a small enterprise may also be the owners and take a keen interest in the planning process. A plan may be intended for prospective equity partners, either a sleeping partner looking for an investment, or an active partner looking to join an existing small business. Owners may also be lenders, who take an equity stake in return for providing loans.
3. **Lenders:** Banks are the main recipients of business plan. They encourage the production of business plans to justify overdrafts and loans offering literature and advice and putting together business plans. Other lenders of money, from private individuals to venture capital companies will also expect to make their investment decision after the presentation of a formal business plan.

3.5 Feasibility Study

A business plan is outline of the step-by-step procedure that would be followed to convert a business idea in to a successful business venture. Before preparing a business plan an entrepreneur identifies an innovative idea, followed by identification of opportunities and threats through scanning of external environment and identify the internal strength and weaknesses by evaluating internal environment, and finally assess the feasibility of idea so that proper allocation of resources is achieved and the business plan get success.

As the name implies, a feasibility study is an analysis of the viability of an idea. The feasibility study focuses on helping answer the essential question of “should we proceed with the proposed project idea?” All activities of the study are directed toward helping answer this question. Feasibility studies can be used in many ways but primarily focus on proposed business ventures. Many individuals with a business idea should conduct a feasibility study to determine the viability of their idea before proceeding with the development of a business. Determining earlier that business idea saves time, money and heartache later. A feasible business venture is one where the business will generate adequate cash-flow and profits, withstand the risks it will encounter, remain viable in the long-term and meet the goals of the founders. The venture can be either a start-up business, the purchase of an existing business, an expansion of current business operations or a new enterprise for an existing business.

Phases of feasibility study

- **Evaluate Alternatives:** A feasibility study is usually conducted after producers have discussed a series of business ideas or scenarios. The feasibility study helps to “frame” and “flesh-out” specific business scenarios so they can be studied in-depth. During this process the number of business alternatives under consideration is usually quickly reduced. During the feasibility process you may investigate a variety of ways of organizing the business and positioning your product in the marketplace. It is like an exploratory journey and you may take several paths before you reach your destination. Just because the initial analysis is negative does not mean that the proposal does not have merit. Sometimes limitations or flaws in the proposal can be corrected.
- **Pre-Feasibility Study:** A pre-feasibility study may be conducted first to help sort out relevant scenarios. Before proceeding with a full-blown feasibility study, you may want to do some pre-feasibility analysis of your own. If you find out early-on that the proposed business idea is not feasible, it will save you time and money. If the findings lead you to proceed with the feasibility study, your work may have resolved some basic issues. A consultant may help you with the pre-feasibility study, but you should be involved. This is an opportunity for you to understand the issues of business development.
- **Market Assessment:** Also, a market assessment may be conducted that will help determine the viability of a proposed product in the marketplace. The market assessment will help to identify opportunities in a market or market segment. If no opportunities are

found, there may be no reason to proceed with a feasibility study. If opportunities are found, the market assessment can give focus and direction to the construction of business scenarios to investigate in the feasibility study. A market assessment will provide much of the information for the marketing feasibility section of the feasibility study.

- **Results and Conclusions:** The conclusions of the feasibility study should outline in depth the various scenarios examined and the implications, strengths and weaknesses of each. The project leaders need to study the feasibility study and challenge its underlying assumptions. This is the time to be skeptical. Don't expect one alternative to "jump off the page" as being the best scenario. Feasibility studies do not suddenly become positive or negative. As you accumulate information and investigate alternatives, neither a positive nor negative outcome may emerge. The decision of whether to proceed is often not clear cut. Major stumbling blocks may emerge that negate the project. Sometimes these weaknesses can be overcome. Rarely does the analysis come out overwhelmingly positive. The study will help you assess the tradeoff between the risks and rewards of moving forward with the business project. Remember, it is not the purpose of the feasibility study or the role of the consultant to decide whether or not to proceed with a business idea. It is the role of the project leaders to make this decision, using information from the feasibility study and input from consultants.
- **Go/No-Go Decision:** The go/no-go decision is one of the most critical in business development. It is the point of no return. Once you have definitely decided to pursue a business scenario, there is usually no turning back. The feasibility study will be a major information source in making this decision. This indicates the importance of a properly developed feasibility study.

3.5.1 Feasibility Study vs. Business Plan

A feasibility study is not a business plan. The separate roles of the feasibility study and the business plan are frequently misunderstood. The feasibility study provides an investigating function. It addresses the question of "Is this a viable business venture?" The business plan provides a planning function. The business plan outlines the actions needed to take the proposal from "idea" to "reality."

The feasibility study outlines and analyzes several alternatives or methods of achieving business success. The feasibility study helps to narrow the scope of the project to identify the best business scenario(s). The business plan deals with only one alternative or scenario. The

feasibility study helps to narrow the scope of the project to identify and define two or three scenarios or alternatives. The person or business conducting the feasibility study may work with the group to identify the “best” alternative for their situation. This becomes the basis for the business plan.

The feasibility study is conducted before the business plan. A business plan is prepared only after the business venture has been deemed to be feasible. If a proposed business venture is considered to be feasible, a business plan is usually constructed next that provides a “roadmap” of how the business will be created and developed. The business plan provides the “blueprint” for project implementation. If the venture is deemed not to be feasible, efforts may be made to correct its deficiencies, other alternatives may be explored, or the idea is dropped.

3.6. The Planning Process

Planning is a three-stage process:

1. Understanding where you are;
2. Deciding where you want to go; and
3. Planning how to get there.

The business plan is just like map reading; decide on where you are; the town you want to go and then you can start to plan your route. You might decide not to go in a straight line because there are longer but faster routes; you might be forced to take diversions because unexpected road works upset your plans; you might not get to your destination as quickly as you expect because the car breaks down. Indeed it is just possible that you will never reach your destination at all because of an accident. If you cannot decide where you are or where you want to be, the map is of little use. If you know where you are and where you want to go, a good map increases the chance of getting there. And planning the route will also help you estimate the petrol you need and the money you will therefore need to buy it. The business planning process is simple but systematic.

Activity

Student, let now you check your understanding for the above readings:

- ☐ What are the three major constituents of a business plan?

1. Understanding where you are:

- ☐ Understanding your product or service and how it is better and worse than that of your competitors – your competitive advantage: to understand the position of our product, we must answer the following questions:
 - ☐ How do you compete in terms of price, quality and so on?
 - ☐ Is the product or service differentiated in any way?
 - ☐ How can this be reinforced?
 - ☐ Can the product or service be easily copied?
 - ☐ Can you discern any patterns in successful or unsuccessful competitors?
- ☐ Understanding who your customers are and why and how they will buy from you:
 - ☐ Can you identify market segments and can you get to them?
 - ☐ Are your existing customers happy with the product or service?
 - ☐ What is good and bad about your marketing mix?
 - ☐ Can more customers be found who are similar to your existing customers?
 - ☐ Are you selling to a niche market?
- ☐ Understanding your own and your firm's strengths and weaknesses:
 - ☐ What are your own aims, your own strengths and weaknesses?
 - ☐ How good are your people and your facilities?
 - ☐ Are you good at leadership and communication?
 - ☐ What are the critical success factors – those things that it is crucial that you get right if you are to grow?
 - ☐ What will be the critical problem areas if you grow?
 - ☐ Do you have money of your own to put into the business?
- ☐ Understanding the opportunities and threats that the market might present you with:
 - ☐ Are market tastes changing?
 - ☐ Is the market growing?
 - ☐ Are there changes in the social, economic, political or technological environment that are likely to affect you in the future
 - ☐ How easy is it for competitors to come into your industry? Do you have new product or service ideas?

2. Decide where you want to go:

Decide the general aims you have for your business and for you. Do you want a lifestyle or do you want to go for growth? For some firms, aims become „mission statements“ – statement of what the owner-manager wants the business to become. For example, a medical general practice came up with the mission „to provide the best possible healthcare for patients at all times by responding to needs, providing accessible medical and anticipatory care of the highest quality and doing all that is possible to improve the social environment of the community“.

Set some specific objectives that signal you have achieved your aims. Objectives must be qualified, bounded in time and realistically achievable. They can then serve as useful goals and yardsticks against which to judge your performance. For example, an objective might be to achieve profit growth of 10 percent with a minimum return on capital of 15 percent. Objectives are the milestones on your journey. They tell you where you are going and let you know when you have arrived.

3. Planning how to get there:

- ☐ Strategies need to be developed to enable you to achieve your objectives. Strategies are „how to“ statements. They are not complicated; they are just „joined -up“ tasks. Their development involves co-ordination of the different management functions, marketing, operations, people and finance.
- ☐ In particular, you will need to develop a marketing plan that produces a consistent and coherent marketing mix to address how to sell the product or service to the different customers.
- ☐ You will need to draw up financial budgets – profit and cash flow forecasts to see what financial resources are needed to undertake the plan. Do you need to attract investors? Can you? If not, your plans might have to be modified.

The whole process is shown in the Figure that follows. It starts with the aims of the owner-manager and the mission for the business. It is vital that owner-managers are truthful to themselves about their own aims – otherwise the rest of the plan will be useless. The next element is a SWOT (strengths, weaknesses, opportunities and threats) analysis which gives a realistic appraisal of the options open to the business.

Activity

- ☐ Please discuss major question under the first stage of the planning process „where are we now“
 - ☐ Explain why strategy is important in the third stage of the planning process „how to go there“
-

3.7 Contents (Tasks) Of Business Plan

Task 1 – Introduction to the business plan

This is your first and perhaps easiest task in writing a business plan. In this element of your business plan you are to introduce your company to the reader and explain the purpose of your business plan. It should be used to briefly familiarize the reader with who you are, what the goals of your business are, and when these goals will be accomplished. If you are presenting your plan to a banker, you may state how much you intend to borrow, and what you intend to do with the funds.

Contents of this section:

- (a) Mission: the mission for the business, the formal mission statement that defines the business.
- (b) Overview of key objectives:
 - Financial objectives: the turnover and the profit targets for the period of the plan, the growth desired over the previous period.
 - Strategic objectives: achievements in the market and gain to be made in market positions.



Sample 1:

M2K, Plc. is a private company whose principal business is the manufacturing and distribution of different educational, construction and health equipments. The purpose of this business plan is to outline the firm's goals for the next five years and to detail the actions required to implement its goals. M2K's goals are to:

- ☐ Increase profits through expanded sales to near by east African countries by July, 2011.
- ☐ Identify alternative sources of supply for raw materials by December, 2011
- ☐ Seek additional financing to cover expanded production and sales by June, 2012.



Sample 2:

Terrific Picture Framing is a proprietorship whose principal business is the manufacturing and retailing of picture frames and custom restoration work of antique picture frames. The purpose of this Business plan is to outline the proprietorship's goals for the next three years and to detail the actions

- ☐ Start manufacturing and retailing by May 2010.
- ☐ Achieve profitability by January, 2011
- ☐ Seek adequate financing for the first year of operation

Sample cover page

Name of the business:

Type of business:

Prepared by:

Name of owner:

Address:

Telephone:

Date:

Task 2 – Description of the Business

This section of the Business plan provides background and other information on how your business was started and how it is presently doing or, if a proposed business, how and when you plan to start it. The preparation of this section should be quite easy since owners of both start-up and existing businesses will already know most of the information that needs to be included here.

Contents of this section

For an existing business, the following topics should be covered:

1. Name of Business: Legal name and trade name, if any.
2. Date and place of registration or incorporation, if any.
3. Date actual operations began or planned to begin.
4. Brief history: Discuss the type of business, the major events in the past operations, and discuss the results, mentioning sales history when pertinent.
5. Form of business organization: Corporation, partnership or proprietorship.
6. Names of owner, partners or major investors

For a proposed business, provide as much of the above information as is possible. Instead of a brief history, you should explain what the business is expected to develop. Indicate the approximate date that you expect to begin operations. If the business has not been registered, indicate the approximate date that you expect to register it and the state that it will be registered in.

Note: This section does not require much detail. Most businesses should be able to provide all the information needed in less than a page.



Laser Light images, Ltd. Was incorporated in India in 1979 by Doug Wilson, Mary Tyler and Mike Steven. Each of the three is an owner of one third of the outstanding shares of common stock of the company. Each is also an officer of the company.

Since its formation in 1979, the company has concentrated on doing laser research and development. As a result of these many years of work, the company has, in addition to

gaining experience with lasers, developed a process on which it presently has a patent pending. The company is also working on an additional process for which it expects to make another patent application. These two processes are discussed in further detail later in the business plan.

The company has operated for the past many years on a budget so limited that no employees were hired and salaries were not paid to the officers. During this time, little attempt was made to sell the products that resulted from the company's experimental work. The company has received less than \$1,500 in revenue since its inception; in short, the company's track record is in its R & D successes.

Activity

- ☐ *Define mission*
- ☐ *Describe the major contents of the second task „description of the business“*

Task 3 – Description of product or service:

In this section of the business plan you discuss the product and/or services that you will be selling. Part of the information that will be included in this section is for the benefit of outside readers who may not be familiar with your business. Part of the information will be useful to you, however, since the research and analysis required will force you to examine your offerings vis-à-vis your competitors.

The following four topics should be found in this section of the business plan:

☐☐☐ **Description of Products and/or Services**

Explain what it is that you are selling. Be specific. The reader should be given more than just a vague idea about your products and/or services. Obviously, some products and services will require much less explanation than others. A pitfall that you should be careful to avoid in this

section is making the assumption that the reader can easily understand your products or services without you providing sufficient detail and description.

☐☐ **Status of the Products and/or Services**

Are your products and/or services available for sale now? If not, what needs to be done to develop them? If you are selling a product, does it require more design work? Does it need more research and development? Have you actually produced one or more completed products? If you are selling a service, do you presently have the skills and technical capability to provide it? If not, what needs to be done? If additional inputs are required before your products or services can be sold, indicate the amount of time that you will need to complete this process.

☐☐ **Proprietary Position**

Do your products and/or services have any competitive advantages because of patents, copyrights, trademarks, franchise or dealership rights, and the like? If so, explain the advantages and state how long this proprietary position is likely to last.

☐☐ **Comparison to Competitive Products and/or Services**

Identify those products and/or services which you think will be competing with yours. These may be similar products and/or services or they may be products and/or services which, although quite different, can be substituted for yours. Once you have identified the competing products, compare yours against the competition. List the advantages and disadvantages of yours vis-à-vis your competition.

After making the comparison, state the conclusions that you draw from it. Are your products and/or services likely to compete effectively? If so, explain why you feel this is so. If not, decide what changes will be made; make the necessary changes, and do another comparison. When the results of the comparison are satisfactory, revise this section of the business plan to reflect that.



Sample 4

Description of Product:

The only product that the Hager Processing Plant will produce and sell is a line of processed fruits. The line will consist of four types of products (orange marmalade, tomato paste, guava and tomato juice), which are bottled in different sizes of cans.

Status of the Products:

The product is ready for sale. The plant experimented with various techniques for producing the product and eventually settles on the one process which proved to be particularly efficient. To date, Hager has produced the mentioned types of products using this process and all of them are suitable for selling.

Comparison to Competitor's Products:

The plant has few numbers of competitors. Most of them are currently operating in the central part of the country. Since our firm is new to the market some competition is expected especially at the first six months of the plant's life. Upper wash agro industry is the best known and experience firm in the industry. This firm is fifteen years old and has a competitive advantage of cost. However we are hopeful that our plant will penetrate and win the customers mind.

Task 4 – Customers:

The purpose of your market research is to identify your market area (i.e., the geographical area where the majority of your customers are located), market size, (i.e., how much money people spend in a year on your kind of product or service in your area), and market trends (i.e., what is expected to happen to this market in the future). In the next three parts of your business plan, you will be asked to discuss three components of that market: customers, competitors, and products (or services). You should analyze your likely customers, noting those points that are important to your business.

Contents of this section:

Determine in detail that your customers are? or are likely to be. Be as specific as possible. If the number of potential customers is relatively small, actually name names if you can. For

instance, if you will be selling only to Hotels, and there are only a dozen in your market, then list each of them.

Usually, though, you will have hundreds, thousands, or even more potential customers. Obviously, you cannot list them all. Instead, you will want to try to categorize them, and then describe the characteristics of each category. Let us say that you are a wholesaler of candy and gum products. After your research, you may decide to categorize customers in the following way:

- a. Food stores, 10,000 square feet and up
- b. Food stores, fewer than 10000 square feet
- c. Candy stores, 800 square feet and up
- d. Candy stores, fewer than 800 square feet
- e. Candy departments in department stores
- f. Entertainment facilities: movie theatres, sports arenas, etc
- g. Vending machine companies.

If you sell to the general public, instead of to other businesses, then you may need to group potential customers according to their demographics, such as age, income, education, ethnicity, etc. Assume that you plan to start a retail apparel store. Based on your marketing research, you may decide that your potential customers are likely to be, in order of importance, the following groups:

- a. Women, ages 16 – 24
- b. Women, ages 25 – 34
- c. Women, ages 35 – 44
- d. Men, ages 25 – 34
- e. Men, ages 35 – 44
- f. Women, ages 45 – 54

g. All others

The more precise your description of the customers, the better able you will be to, among other things:

- a. Determine the type and mix of clothing to sell. There is likely to be a big difference in the styles and prices of clothing that 25 year old men and 45 year-old women buy.
- b. Determine the best location for your store. You want a location that is likely to draw those people who are your potential customers.
- c. Determine your advertising strategy. The more you know about your customers, the better able you will be to design appropriate advertising, to select the proper media, and to decide when to advertise.

While you need to know who your potential customers are, it is useful to also know how much each individual target group will contribute to your business. This was implied in the above examples where customers were ranked according to their importance. Determining relative importance however is not an easy task. What determines how important a customer, or group of customers, is? Certainly profits are the final determinant. Unfortunately, estimating your profits for each customer, or group of customers, is a difficult task in most cases. It is difficult because it requires not only a determination of the amounts that a particular category of customers are likely to spend but also an estimate of the mix of products or services that they will spend the money on. It is quite possible that those who buy the greatest amount of merchandise will not be your most profitable customers, if they tend to buy items that carry low mark ups. If you can make estimates about the importance of customers in terms of profits, then do so. Often, though, this will not be practical. Instead, you may have to use estimated sales as your basis for the ranking.

Certainly, *the more you know about your potential customers the better off you will be*. We suggest that, at a minimum, you determine and provide in your business plan the following:

1. Who your customers are likely to be. Determine, in as much detail as you think appropriate, the income, sex, ethnicity, age, education, etc. Characteristics of your potential customers.

2. What the potential customers think of your products and/or services.

What do they perceive as the strong points of your products and/or services? What do they see as the weak points? Can you use this information to make your products and/or services? What do they see as the weak points? Can you use this information to make your products and/or services more appealing to potential customers?

3. The outlook for your business.

Based upon your customer research, does it look as if you could expect enough customers to make your business profitable? If so would it require changes in your product services and/or business operating?

NB. Because customers are only one factor in determining business success, you can not say, at this point, that the business will be successful just because your customer research is encouraging. That decision can be made only after consideration of many other factors. However, if the answer to this question is negative, then you may be able to say that the proposed business is not worth pursuing further.



Sample 5

Identification of Potential Market

1. Number of Potential customers

According to the Land Transportation Facilities Division, Addis Ababa Department of Transportation, there are 22,500 taxicabs registered in the city limits. All 22,500 are potential customers for the repair and maintenance of taxi meters, which the only service is offered by the Dynamic instruments company. All 22,500 taxicabs are either owned by, or under contract to, sixty (60) taxicab companies. Following is a breakdown of the 60 companies by size

Size (No. of cabs)	No. of Companies	Total cabs
1000 or more	5	1,400
100-999	17	970
20-90	18	110
1	<u>20</u>	<u>20</u>
Totals:	60	22,500
Source: Land Transportation Facilities Division, Nairobi		
Department of Transportation records (2009)		

The city of Nairobi will not issue any new licenses for the next five years, keeping the total number of outstanding licenses at 22,500. Thereafter, the total number of licenses outstanding is expected to grow only at 3% per year. (Source: Nairobi Traffic Record, April 31, 2008.

2. Characteristics of Potential Customers

In order to find out more detailed information about the customers, Dynamic instruments personally interviewed the owners and/or managers of 20 of the companies; five were from each size classification. After analyzing the data gathered from these interviews, a summary of the most important information was prepared. A copy of that summary is presented on the next page. The summary shows the following characteristics:

A. Regularity of Maintenance

Those companies with 10 or more taxicabs are circumspect about performing regular maintenance, while those with fewer than 10 are not.

B. Emergency Service Requirements

As one might expect, the need for emergency service varies in relation to the type of meter used and the amount of maintenance performed. The larger companies require few emergency calls while the smaller companies require many.

C. Selection of company

The larger companies select their repair and maintenance services primarily on the basis of promote service, with price being of secondary importance.

3. Target Market

Based upon the information presented in the identification of potential market Section above, Dynamic has defined its target market as “those taxicab companies operating in Addis Ababa.”

Dynamic has segmented its target market into primary and secondary customers. Primary customers are those companies with at least 10 taxicabs that use either Lada kind or minibus.

All companies with 2 to 9 taxicabs and those companies with more than 10 taxicabs that use caps other than the above mentioned are considered to be secondary customers.

Activity

- ☐ *Four topics should be found in the „description of goods and service“ section of the business plan, what are these topics?*
- ☐ *Please describe how to estimate the size of the market for a given product in the business plan.*

Task 5 – Competition:

You can learn exceptionally important lessons about your business by noting how your competitors operate their businesses. Find out as much as you can about the m. Try to learn as much as you can from their successes and their failures. Competition can be inspiring rather than threatening if it is fully researched and understood.

Following are some of the subjects that you should include in this section of your business plan:

☐ ☐ **Description of Competitors**

Identify those businesses which will be competing with you. If the number is few, list them by name. If there are a large number, then describe the group without naming them individually. List any expected or potential competitors.

☐ ☐ **Size of Competitors**

Determine the assets and sales volume of the major competitors. Will you be competing against firms whose size is similar to yours or will you be competing against giant corporations? If assets and sales volume cannot be determined, try to find out indications of size such as number of employees, number of branches, etc.

☐ ☐ **Profitability of Competitors**

Try to determine how profitable the business is for those companies already in the field. Which firms are making money? Losing money? How much?

☐ ☐ **Operating Methods**

For each of the major competitors, try to determine their relevant operating methods. For example, what pricing strategy does each firm use? In addition to price, you may also want to consider:

- | | |
|---|---|
| a. Quality of product and/or service; | g. Location; |
| b. Hours of operation; | h. Advertising and Promotion; |
| c. Ability of personnel; | i. Reputation of company and/or principals; |
| d. Servicing, warranties, and packaging; | j. Inventory levels. |
| e. Methods of selling; distribution channels; | |
| f. Credit terms; volume discounts; | |

N.B. Many of the above items will not be relevant to all businesses. On the other hand, there are many items that are not listed above which may be very relevant to your business. You can see, then, that it is very important for you to determine those particular characteristics which have relevance in your business on which you will do your research.



Sample 6

Despite the fact that there are over 100 furniture dealers in Kuala Lumpur, the bulk of the apartment and condominium furniture packages are sold by six firms. In my market research, I found that from 80 to 99% (depending on who you talk to) of “packages” wear sold by those six firms. The firms are identified by name in Table below.

Product characters

To get information on the products sold by each of the firms, I talked to eight developers who had selected one or more of the six firms to provide a furniture package for their units. I also talked to 23 individuals who had purchased a package for their unit from one of the six firms. In general, the purchasers felt that their furniture was performing about as they had expected; the one exception was that buyers of the Apartment Furniture Co. all felt that the quality was not as good as they had been led to believe. Based upon these findings, I have divided the six into three groups, and labeled them as follows:

1. High quality, high price

The only firm in this category is Rattar imports which sells only rattan furniture. One would expect, their sales are to the more expensive developments.

2. Moderate price, high quality

Again, only one firm, Georgian Furniture, is in this category. The bulk of its sales were made in developments where 1 bedroom units cost from \$75,000 to \$100,000, although they did get the contract for one more expensive building.

3. Low price, varying quality

Four of the six firms appear to be competing in the lower end of the package deal market. Three of the four are selling “casual” furniture, and the fourth is selling bamboo furniture. Overall, there is not much difference in warranty and delivery service, but there is some

variation in price (from a low of \$4,200 to a high of \$5,100) and upkeep (Apartment furniture company and bamboo things" Ltd appeared to require less maintenance than the other two). There is, however, a wide disparity between the firms in trade-in value. Bamboo Things furniture holds its value much better than the other firms" products, almost 2.5 times than AAA and Apartment Furniture

Company Characteristics

By talking to four of the six firms (the other two refused to discuss their firms with me), and by researching various published source, I was able to prepare Table 2. Some characteristics that bear mentioning are:

1. All six firms used in-house salesmen rather than manufacturers" representatives.
2. There does not seem to be any particular correlation between performance and the number of years in business.
3. Although the sales of the two firms that concentrate on the higher priced furniture are relatively small, their profits as a percentage of sales are very high.
4. The two firms that manufacture their own furniture have the lowest profits as a percentage of sales.

Analysis of Competition

Based upon the data gathered, the following analysis of the competition seems reasonable:

1. The high-price, high-quality segment of the market seems the most profitable. There is only one competitor; the firm has been in existence only two years and sales are already over \$500,000 a year; profit/sales is running at 25% and the firm is not quite as aggressive as it could be since it required full payment on delivery.
2. The moderate-price, high-quality segment of the market also seems to have good potential since there is only one firm presently in the market. On the negative side, this firm has been operating a year longer than Rattan imports and seems to be more aggressive than Rattan (as shown by its lower profits/sales ratio and its more liberal credit policy), yet its total sales are less than Rattan"s. On the positive side, the profits/sales ratio may be low because of some inefficiency on the company"s part.

3. The lower-priced segment of the market seems to be very competitive. Of particular concern is the fact that two of the firms manufacture their own furniture. AAA Furniture is the leader in terms of both price and sales, and yet its profits and those companies are willing to accept low profits because they are making the bulk of their money manufacturing. This fact is important because it means that they could even afford to sell at a cheaper price and make money.

Table 1
Company information

Competitors Names	sales	Profits	year started	credit terms	salesmen representatives	Manufac Turer
Condo Suppliers Co.	750,000	125,000	1969	50%	Salesmen	No
Georgian Furniture	300,000	60,000	1974	50%	Salesmen	No
AAA Furniture, Inc	1,250,000	75,000	1995	cod	Salesmen	No
Rattan Imports, Inc	500,000	125,000	1998	cod	Salesmen	No
Bamboo Things, Inc	600,000	150,000	1989	50%	Salesmen	No
Apartment Furniture Co	400,000	10,000	1978	cod	Salesmen	Yes

Task 6 – Location:

If location is not a critical factor in your marketing strategy, it does not need to be discussed in this part of the business plan. Instead, you should describe your location in the “production plan” section. If, however, location is important in selling your products and/or services, that should be noted here. The first step is to explain why your location will be important to the business” success. What did you find in your data collection that justifies spending a lot of

money for a good location? What general type of location do you require? Do you have specific criteria against which various locations can be measured? This might include such things as the amount of traffic, the amount of parking, visibility, proximity to similar businesses, proximity to competing businesses, etc. Once you have identified the type of location required, you can then begin looking for specific locations. We recommend that you look at as many locations within your market area as time permits. Each one should be measured against the criteria that you have set.

When you are preparing this element of the business plan, please keep these three items in mind:

1. Almost every benefit has a cost associated with it.

This is particularly true for your location. Make sure that you carefully evaluate the cost of each location against the expected benefits.

2. Choose the location with the business in mind

Don't start with the location as a "given". The problem with this approach is that you "force" the business into a location that may or may not be adequate. If the business is "given" (i.e., already decided upon) then the location should not also be given. You should choose the best location (i.e., the one that yields the most profit) of the business. "Free" locations can end up being very expensive if it is not an appropriate one.

3. When you write your business plan as a financing tool, you often will not have the specific business location selected prior to completion of the business plan.



Sample 7

The Gujarat Garden Supply Center (GGSC) recognizes that the proper location is a very important element in the success of this type of business. The March, 1978, issue of Retail Gardening reports that location is second only to "wide selection" as a factor in determining business success. The article reported that those stores located in suburban areas, with populations of 7,500 people within a 5-mile radius, were most likely to succeed. The article

also noted that high disposable personal incomes of the surrounding population promoted success.

With this in mind, GGSC identified the Westchester and Punjab Heights areas as being the most promising. After looking at 11 locations in those 2 areas, a site at the Westchester Shopping Center was finally decided on. In addition to meeting the above criteria, this location also offers ample parking and is located in a fast-growing area.

Activity

- ☐ Under „location“ section of the business plan, we need to keep three items in mind: what are these items?
- ☐ Dear learner, what is the importance of giving emphasis for our competitors in the business plan?

Task 7– Pricing:

In this task, you have to consider your pricing policy. Pricing is often one of the things that a small businessman spends too little time on. Pricing decisions are often made only on the basis of competition or by routinely applying some standard markup formula. The determination of prices should be done, however, taking a lot of other factors into consideration. Some factors that you may want to consider are:

☐☐ Cost

If you wholesale or retail merchandise, you should explain the basis of your markup. If you carry a variety of merchandise with different markups, explain the average markup (or gross profit percentage) that you shoot for. If you manufacture a product or sell a service you should do a cost analysis, breaking down the direct costs into their components (i.e., direct material, labor, shop overhead).

□□ **Consumer Perceptions**

Another consideration when setting your prices is the perception of the value of your products and/or services by the consumer. Your customers' opinions of value may have little or no relation to the cost of the merchandise or to the price charged by the competition. You may be able to apply much more than the normal mark up, or you may be unable to sell the product for what it cost you.

□□ **Competition**

Competition is, of course, an important consideration in pricing. However, you must analyze the competition in the context of the total business operation and the environment that you will be operating in. For example, even though you sell exactly the same product as a competitor, your prices may need to be much higher or lower than his, for several reasons. Your costs of operation may be much higher or lower than his, which may be reflected in the price that you charge. You may offer more or fewer other benefits to the customer

(eg. Convenience, servicing, warranties) which justify a higher or lower price. Your customers may be different from his in that they are willing to pay a higher or lower price.

Sample 8

The average markup by Bigmack Health Food Company's (BHDC) competition is 300%. This markup is necessitated by the high cost of their locations and the cost of personnel. After careful analysis of the costs involved, BHFC has determined that it can use a markup of only 200% and still make a sizeable profit. BHFC will be able to do this because:

1. Its location costs will be one-third less than that of the major competition.
2. The employees' costs of BHFC will be only 20% of the cost incurred by the competition. This is due to the fact that BHFC's customers will be almost entirely long-time health food devotees who will not need assistance or advice to select their purchases. The competition on the other hand, has a constant stream of people who are novice health food consumers or who are not interested in health food but want to purchase on a one-time basis, a particular product. These types of people require

a lot of advice and instruction, and thus several employees must be working at all times.

The company will sell on credit to several health food restaurants. It will require that they pay C.O.D for the initial order but will allow a net 15” account thereafter, if their credit is adequate. All other sales will be on a cash basis.

Task 8 - Marketing Methods:

Contents of this section:

In this section, you have to think about how you are going to market your goods or services. It is not enough just to have a good product. Think about the last time you bought a newspaper or a package of cigarettes or a snack. Why did you buy the one you did?

It was in the right place for you.

It was there at the right time for you.

It was at the right price for you.

It was the right product for you.

You knew it was there.

Think about the product or service your business offers, or that you plan to offer. Will it be right for your customers, in the same way that your last purchase was right for you? Some businesses people think that the product and its price are all that matter. If you think about anything that you yourself have ever bought, you will realize that this is not the case. You must also answer the following questions about your product or service, and put the answers in your plan.

☐ ☐ Advertising

o How will you tell people about your business?

- o Where do your prospective customers find out about sources of supply for what they buy?
 - o Do they read newspapers, watch TV, or listen to the radio?
 - o Do they learn from their friends and neighbors or do they see things in the shops as they pass?
 - o How much can you afford to spend on advertising?
 - ☐ What will it be worth to you to gain an extra sale?
 - ☐ Timing
 - ☐ When do your prospective customers like to buy things?
 - ☐ Will you be able to supply them at those times?
 - ☐ Location
 - o Will your customers come to your place of business to buy from you? If not, will you go to them yourself?
 - o If not, what “Channels” will you use to reach them? The mail, wholesalers and/or retailers, your own sales people, or what?
 - o How much will it cost to transport your goods to where people will buy them, and to pay the people who will actually do the selling? Have you built this into your price?
 - ☐ People
 - o What do your customers think of you and whoever will be doing the selling? Do they trust and believe them?
 - o If not, how can you improve your “image”, that is, the feelings people have about your business, and about the individuals that people associate with your business?
-



The Morocco Locksmith Company believes that its sales will be increased through the following marketing strategies:

1. We shall distribute handbills to all the potential business and home customers in the area of the shop the week before opening business.
2. We shall spend \$50 on a small display advertisement in the tower Chamber of Commerce services directory, which is well used by all businesses in the area.
3. We shall follow up contacts with the local newspaper to insert a series of stories on the need for good security to protect against theft.
4. We shall liaise with local insurance brokers to ask them to recommend that their customers contact us if they need to bring their security arrangements up to standard.
5. **24-Hours Service.** The company will provide radio-controlled vans to its employees so that service calls can be made around the clock. This is an important point since many emergencies involving locks and keys occur during non-business hours. One of the best ways of building customer satisfaction is to provide prompt service during these hours.
6. **Uniforms.** All company personnel will be neatly dressed and will be issued company uniforms. This is important because the nature of the business requires trust on the part of the customer. People are naturally averse to letting strange people into their homes and businesses, particularly at odd hours. Therefore, the use of the uniforms will help in alleviating their anxiety.
7. **Refinishing Capability.** The company will provide tools and materials for quick refinishing work after a job is completed. One of the biggest complains in this business is that once a work is completed, the door, window or safe is again secure, but it does not blend in with the surroundings the way it used to? Often this cannot be avoided if the work is to be done. However, we will make attempts to restore the damage to its original condition when possible.

Activity

- ☐ *Learner, what kind of factors should be considered in setting the price for goods and services?*
 - ☐ *The four P's are important in thinking about marketing, please discuss how can we include and analyze these P's*
-

Task 9 - Key personnel:

In this section of the workbook you are asked to identify the key people in your business. Key personnel include **the owner(s) and other difficult to replace management people**. However, if you have a non-managerial person who is also critical to the success of the business, he should be included in this element. An example of a non-managerial person who should be included is the operator of a piece of equipment, if such operators are extremely hard to find and if the lack of such an operator would seriously hamper the company's business.

You should include a brief description of each person's qualifications in this section. Unless it is obvious, you should explain why you think the person is qualified to hold the position. Point out any particular strengths or weaknesses of the people. Next, you should prepare job descriptions for each of the key management positions. Include the complete description in the appendix, and provide a brief description of the positions' duties and responsibilities in this section. If your business is a corporation, list the names and addresses of all of directors. If the business is a partnership, list the names and addresses of the partners.



Sample 10

The following is a list of the company's directors and officers:

1. Ronald H. McDonald, Director and President

2. Donald H. McDonald, Director and Vice President
3. Patty Berger, Director and Treasurer
4. K.F.C. Sanders, Director and Secretary
5. Mack Berger, Director
6. Jack Berger, Director

Resumes of each of the six, detailing their experience and background, are presented in Appendix III.

The experience and background and duties and responsibilities of the four key employees are provided below.

1. Ronald, H. McDonald President

- A. Experience and Background: see Resume, Appendix III.
- B. Duties and Responsibilities 1) Supervise day-to-day accounting operations; 2) Liaison with company's financing, legal, and accounting contacts, 3) implementation and supervision of policies and procedures set by Board of Directors 4) Long range planning.

2. Patty Burger, Treasurer

- A. Experience and Background: see Resume, Appendix III.
- B. Duties and Responsibilities 1) Supervise day-to-day accounting operations; 2) Conduct semiannual internal audit; 3) Oversee investment activities; 4) Prepare yearly and monthly budgets; 5) Prepare payroll and tax forms.

3. Donald H. McDonald, Vice President

- A. Experience and Background: see Resume, Appendix III.
- B. Duties and Responsibilities 1) Supervise purchasing and inventory control; 2) Responsibility for all personnel function; 3) Responsibility for marketing and advertising.

4. Juan Cater plunder, Sales Supervisor

- A. Experience and Background: Mr. Plunder has been employed in retail sales for seven years, the last three as head sales clerk at Wendy's Health Food Center in Washington, D.C.
 - B. Duties and Responsibilities: 1) Hiring and firing of sales clerks; 2) Employee scheduling; 3) Supervision of day-to-day selling activities.
-

Task 10 - Materials and sources of supply

The purpose of this section of your business plan is to determine what materials you will need and where you will get them. Note that we are referring to production materials or other critical materials, and not to office supplies, nuts and bolts and the like.

You should prepare a table listing the various materials. For each of the materials, state how many suppliers there are that you could buy from? If there are many suppliers, use the phrase "many" as there is no need to count them all. Next indicate which will be your primary supplier and why. Have you chosen that supplier on the basis of price, variety, service, credit terms, delivery times etc? The purpose of this table is to show outside readers that you have in fact, analyzed your sources and selected the one that best fits your needs, rather than arbitrarily selecting one.



Sample 11

Following is a list of the critical materials that are used in Christine Diog's production process, the number of available suppliers, and her primary supplier.

Material	Number of suppliers	Primary supplier
Eucalyptus Boards	3	Smith's Eucalyptus, Inc
Plastic Bubbles	1	Supply Resources, Inc.
Glass Panes	Many	City Glass Products
Redwood Stain	Many	Hardware Materials, Ltd
Hooks & Fasteners	Many	Hardware Store
Resin	Many	Ralph's Plastics
Orchids	8	Pacific Nurseries
Ferns	6	Oceanic Growers Corp
Plating Chemicals	Many	Anderson Chemical Co
Frames	Many	Willy's Frame Company

Activity

☐ ☐ What kind of person is a key for a given venture?

☐ ☐ Materials and their sources are very basic for the proper operation of a new venture, but how can we find reliable and strong suppliers?

Task 11- Manufacturing and production:

Explain the process and equipment used to make your product. If your business is primarily marketing or administrative, you will be able to omit this section. Most service businesses also will not need to complete this section. You should provide a step-by-step explanation of the process used to make your product. At each step you should explain the work done, the

person doing the work, the equipment used, and the material involved. This information is useful to an outside reader because it not only gives him some basis for evaluating your cost analysis. If the process is a complex one, it is advisable to include a diagram showing the workflow. As part of this explanation it is useful, though not mandatory, to show the time required to complete the process and the number of person/hours (or minutes or days, etc) used at each step of the process.

Once you have explained your methods and equipment, you should compare them to any available alternatives. Do your methods and equipment reflect the present “state of the art” or are you behind the times? If your methods and equipment leave something to be desired, then you should explain what you intend to do to correct the situation, or why no action is required.



Sample 12

Christine Diog’s production methods are primarily those of assembly, although the flower plating and arranging are semi-skilled functions. Flowers are plated in copper, lead, gold and/or silver and are then attached to eucalyptus boards which have been stained. Then the boards are assembled into pictures via the addition of frames, glass (for plastic bubbles) the wall hooks.

Following is a description of the process, including the equipment used, the personnel involved, and the completion time. (All times shown are in person hours for 1,000 units and include setup time, if any).

	Process	Equipment	personnel	Person hours
1	Electroplating Flowers	M2,00plating unit	Platter	14
2	Drying flowers	Steel work drying	Platter	2
3	Buffing flowers	Oamey deluxe	Platter	13
4	Staining boards	None	Production worker	12.5
5	Drying boards	Steelwork drying	production	6
6	Arranging flowers	None	arrange	21
7	Farming	LTX machine	framing Production worker	39
8	Enclosing frame	Hand tools	Production worker	17
9	Adding wall hooks	Hand tools	Production worker	6

The total time required to complete 1,000 pictures is 131 person hours. Since some of the steps are done concurrently, however, the total elapsed time from start to finish is only 112 hours.

Task 12 - Sales forecast:

One of the most difficult endeavors for a new business is to predict the volume of sales when the door's open. For the existing entrepreneur, the question is how much can be gained by expansion or diversification. The question thus arises: what approach will produce a realistic sales forecast? Unfortunately, there is no good answer to that. If it were easy to predict sales, there would be very few business failures. In the final analysis, your sales forecast should be what you think is reasonable, given all the information available to you. The following are some approaches that you can use in order to come up with a reasonable estimate.

□□ **Rules of thumb**

For some businesses, there are rules of thumb which can be used to estimate sales. This is particularly true when you are purchasing a franchise. The franchiser will often do the location study for you and tell you what level of sales you can expect, based upon the traffic count, population in the area, or other important variables.

□□ **Comparison to similar businesses**

If you can obtain information about the sales of competitors or similar businesses in other markets, you may be able to use this information in your sales forecast. Determine what their sales are now and what they were the first year or two that they started. Compare their operating methods, advantages and disadvantages. Relate this data to your operations and see if you can estimate your sales based upon their results.

□□ **Your experience**

If you already in business, the results of previous years' operations will obviously, play an important role in the forecast of sales. If you have sufficient experience you may be able to make a reasonable estimate of sales with nothing but your own knowledge of the business and past performance.

□□ **Pre-Selling**

Another approach to sales forecasting is to line up sales in advance. One way to use this approach is to spend as much time as possible trying to make advance sales. If you spend a lot of time doing this, you may be able to get a "feel" for the amount of sales that you can expect. In other words, you will have some assured sales, some sales that you believe will be made when you call on them again, and some that did not, and will not, buy.

As you can see, there is no standard approach to sales forecast. All approaches are estimation techniques. Since the figures are arrived at through estimation, the criteria against which they should be measured is that of "reasonableness". The question should be "are the figures reasonable?" not "are the figures correct?"

For your business plan, you should include a sales forecast that covers at least two, and preferably three or more, years of operation. For the first year, sales should be shown on a

monthly basis. For the second and later years, sales should be shown on a yearly basis. In addition to showing the sales forecast, you should explain how the figures are arrived at and the assumptions on which they are based.



Sample 13

Market Size

In the newsletter published by the Hawaii Food Association (Jan., 1983, p. 2), Oachealth food sales are projected to be \$2,400,000 in 1985; and \$3,000,000 in 1986. The U.S. Health Food trade group, in its publication

Outlook, (Jan., 1993,p. 105), reported sales of \$2,000,000 (1984), \$2,500,000 (1995) and \$2,800,000 (1986). Since both forecasts are similar, I took the average of two to arrive at my projected market size: \$2,300,000 (1984), \$2,600,000 (1985) and \$2,900,000 (1986).

Market Share

To determine a reasonable market share, I researched the available literature and conducted a study which involved questioning 91 health food store patrons over a five-day period leaving the shops of four of my competitors. Out of this research, I discovered that:

Market share = $63\% \times (69\% \times \frac{3}{4}) + (22\% \times \frac{1}{2}) = 40\%$ of total market. The figures on “Most important factor” were not needed for the calculation; they are presented merely to confirm the assumption that price is the most important consideration, and that BHFC does, therefore, have a sound marketing strategy.

The market share estimate of 40% was analyzed in terms of the information gathered in the market research and industry analysis sections of the Business Plan. BHFC’s findings are these: The 40% market share, while it seems very high, is very reasonable because:

1. All of the competitions are operating the same way (i.e., high markups, labor intensive).
This approach was probably needed in the past, when it was necessary to “sell” customers. However, this approach now is, in effect, subsidizing the education of newcomers. The competition has not recognized the possibility of a split in the market between newcomers

and the knowledgeable customers, whereas BHFC has.

2. Further, even when the competition realizes that BHFC is taking away a sizeable portion of their market, they will not be able to respond to our challenge very rapidly. This is because they are locked into long-term expensive leases; they certainly are not going to want to be a cut in profit margins at the same time they are losing a lot of customers plus, since they are still trying to attract new customers, they will not want to cut staffing drastically.
3. A review of the marketing strategy shows that it is completely in line with the type of high-volume, low-price operation that BHFC will have.

Sales Forecast

The sales forecast is presented on the following table. The first year's sales are projected at \$920,000 (40% of \$2,300,000). The other yearly, and the quarterly calculations, was prepared based upon the following assumptions:

1. Market share will remain about 40% for the three years.
 2. Advertising will be spread equally throughout 4 quarters.
 3. All else being equal, sales are usually highest in the last quarter of the calendar year (40% of annual sales). The other quarters are about equal, although the first quarter may be slightly lower.
-
1. A reasonable estimate of the percentage of health food store patrons who are health food devotees (as opposed to non-devotees who shop at health food stores occasionally) is 80%. These 80% account for 90% of the total sales of these stores. The figures are from Health Food Annual (U.S. Health Food trade group, March, 1982, p. 56). In my test marketing, I found that the percentage of devotees to total customers was about 87%, which is in line with the published figures.
 2. BHFC's target market is, however, experienced health food consumers and other health food devotees. It is important, then, to know what percentage of the devotees have been eating health food for at least six months, (the assumption being that by then they are knowledgeable enough to make their own selections). In the same issue

of Health Food Annual, it was reported that, at any given time, almost a third of all health food consumers had been such for six months or less. This would reduce my target market to 63% of the total health food market, (90% minus 30% of 90%). My test marketing showed that 75% of those interviewed had been consumers for six months or longer.

3. To this point, I have determined that my target market is about 63% of the total market for health food stores. It is no necessary to determine the basis on which these consumers buy. The following summarizes the findings reported in Outlook in the September 1982 issue (p.21), as well as the results of my test marketing, regarding the percentage of devotees who purchase on the basis of price, convenience, reputation, or “other”

Most important factors	„out look“	Test market
Price	81	89
Convenience/location	12	7
Store reputation	6	3
Other	3	3
Don’t know/not sure	8	4

Note: Totals add to more than 100% because of multiple answers. In addition, I also asked each of the persons interviewed if they would patronize a store on Young Street if its prices were one-third less than their present costs. 69% said they “definitely” would; 22% said they “likely” would 6% said they might occasionally; and the rest said it was unlikely. I customers;

I assumed that ½ of those responding “likely” would do the same; I assumed that none of the others would become actual customers. I then calculated a market share for BHFC from these findings.

Sales forecast

	2002	2003	2004
1 st quarter	180,000	204,000	228,000
2 nd quarter	186,000	210,000	234,000
3 rd quarter	189,000	210,000	234,000
4 th quarter	260,000	350,000	390,000
Total year	920,000	1,040,000	1,160,000

Activity

- ☐ According to some scholars, if the kind of the business is basically a service provider and marketing, it is possible to omit the „production and operation“ section of the business plan, do you agree with this? Why? Why not?
- ☐ Please discuss factors that must be considered in forecasting sales.

Task 13 - Forecasting costs

Now that you have projected your sales, you need to calculate your costs so that you can determine if your business is going to make a profit. Costs can be divided into two categories:

- ☐ Startup costs and
- ☐ On-going operating costs

Start-up-costs

Individuals starting a new business need to calculate their start-up costs. Start-up costs are those expenses you must incur before your business can open. You will be able to obtain very

specific information about these costs from doing some information – seeking from suppliers, real estate people (for land /office purchase or rental information), government offices, your competitors, etc.

Startup costs typically include the following:

Furniture and equipment.

This category would include office furniture such as desks and chairs: office equipment such as typewriters, computers, a cash register, equipment and machinery you need if you have a manufacturing or service business; storage shelves, display stands, an outside sign, etc you can obtain this information from suppliers and contractors. Be certain to include installation costs.

Land and building-relation expenses.

This category would include any expenses incurred in conjunction with obtaining the proper location for your business, whether you are purchasing or renting the property. This would include the cost of the building and land if purchasing it, commissions or security deposits payable when renting it, and the cost of decorating and remodeling the location.

Deposits

List any deposits you need to pay utility companies, such as gas, electric, telephone, water.

Initial inventory-Suppliers can assist you in determining the size and cost of your initial inventory.

Legal and professional fees-You can obtain this information from your accountant, lawyer, etc.

Licenses and Permits-You should contact city, state and federal government offices to find out which ones you will need, if any, and how much they will cost.

Insurance premiums -Determine what kind of insurance you may need such as liability, fire, theft, and find out the costs from your insurance agent.

Advertising and Promotion

Other-Determine what other costs you will incur not listed above and detail them here.

Operating costs

Once you have your sales forecasts, you need to work out the costs you will incur in operating your business. These forecasts will enable you tell if your business is going to make a profit or loss during a certain period.

- ☐ If you are in manufacturing, all production costs should be estimated. These would include materials, labor, service and any other costs associated with manufacturing your product.
- ☐ If you are a service business, operational costs should be budgeted.
- ☐ Sales costs should be estimated, including costs incurred in selling and distribution your product, storage, discounts, advertising, and promotion.
- ☐ General and administrative expense such as salaries and legal and accounting expenses should be included.

Your projections should be prepared monthly for the first year of operations and quarterly for the second and third years.

Cost Projections Explanation

1. Based on quotes from suppliers
2. Supplier and wages:
 - ☐ Manager: \$1,200/month
 - ☐ Bookkeeper /secretary: \$700/month
 - ☐ Foreman: \$850/months - \$2210/month
 - ☐ Workers: @\$3.25/hr. @17 /hrs/months – 2210/month
3. Payroll taxes: Assumes 10% of salaries and wage.
4. Employee benefits – Health insurance: 5 people @ \$58/month

5. Rent: Assumed 600 square feet @ 1.75/sq. ft.
6. Utilities: electricity: Based on estimates made by HECO.
7. Advertising: Budget - \$3,000 year. Promotion: Purchase of 50 displays @ \$20/each
8. Cost of company car payments (\$175/month) plus \$70/month gas and \$80/month maintenance.
9. Telephone: includes 1 call to L. A. Each week
10. Supplies and package: Assumed \$300 during first month; \$50/month thereafter.
11. Employees responsible for clearing.
12. Insurance:
 - ☐ Automobile: Based on cost of present policy
 - ☐ Liability: Based on cost of present policy
13. Preparation of annual tax return only; day-to-day bookkeeping done by employees.
14. Miscellaneous expense
 - ☐ Subscriptions: \$100 years
 - ☐ Employee Christmas party: \$1500.
 - ☐ Donations: \$75

Task 14 - Forecast of cash flow

Many businesses fail because owners do not accurately estimate the amount of money they will need to start and operate the business. A cash flow budget is a plan which shows how you think cash will flow into the business (cash receipts) and out of the business (cash payments) month by month during a future period.

A business must have enough cash flowing into pay the day-to-day expenses like: wages, suppliers, rent and electricity. Many businesses have gone bankrupt because they did not have enough cash, even when they had ample sales. The cash flow statement is a financial

projection that will enable you to determine how much money you need. It will help you plan your finances and avoid the financial disaster of being unable to pay your bills when due.

Much of the information that you need for the cash flow statement is the same as you needed for your estimate of costs. However, you will now have to determine the timing (i.e., the month or quarter) of the cash receipts and disbursements. As with the proforma profit and loss statement, preparation of the cash flow statement involved only basic arithmetic calculations; the critical factor is the quality of your data. If, after completing this projection, you find that your cash flow is not adequate, you should go back to your financing requirements elements and revise it accordingly.

When other people read your cash flow statement, they may not understand how you arrived at your figures, or what is included in them. Therefore, as in the projected profit and loss statement you must accompany the cash flow statement with an “explanation of projections”.

Explanations of Projections for Cash Flow Statement:

1. Cash on Hand Day 1:

a. Contributed capital:	\$2,300
b. Bank loan:	\$2,500
Total	\$4,800

2. Cash sales: Assume 25% of total sales in cash. Based upon industry average.

Receivables collected: 75% of total sales on credit. Assumed 10% of credit sales collected in same month as sales: 80th in 2nd month: 5% in third month: 3% in 4th month: 2% uncollectible. Based on experience of similar firms.

3. Other receipts: Month 3-Sale of old equipment. Based on 25% less than market value. Month 7-utility and telephone deposits. Month 11-new bank loan.

4. Base on quotes from suppliers. See Appendix D

5. Payroll taxes: FIICCCA and FUTA paid monthly (\$346): SUTA, TDI, and Workmen’s Compensation paid quarterly (\$300/month).

6. Utilities: electricity paid bimonthly.
7. Telephone paid monthly
8. Advertising and promotion: \$1800 spend first month for displays and Grand Opening: Thereafter, equal monthly payments:
9. Insurance: Automobile paid yearly, liability paid quarterly.

Activity

- ☐ Dear learner, explain what cash flow is all about and how it benefits an entrepreneur. ☐ Is it possible to forecast the cost of a given venture? How?
-
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Task 15 - The Appendix

The last section of the business plan is the appendix and contains supporting documentation. These documents will be used to lend credibility, or provide back up information and evidence for statements or claims you have made in the business plan. All this will assist in your attempt to meet the test of “reasonableness” for everything you have put in your business plan.

On the worksheet provided at the end of this section, make a list of the documents you will append to your business plan. For example, if you claim you have a lease for 1000 square feet at \$50 per square foot for the next 5 years, you would want to place a copy of this lease in the appendix of the business plan to show your banker that your stay in these premises is secure for the duration of the loan period requested. The composition of each business plan appendix will be different, but listed below are some standard documents that are frequently included:

Examples of Supporting Documents:

1. Space leases; outlay sketches of premises
2. Incorporation papers; other legal documents
3. Special licenses, permits required
4. Curriculum vitae/Resumes of key personnel
5. Personal financial statements of owners.
6. Company financial statements (for existing business only)
 - Income statement for last 12 months
 - Current balance sheet (not over 3 months old)
7. Price quotations
8. Product literature
9. Pertinent media articles
10. Letters of intent from prospective customers
11. References (from credible persons)
12. Market research data too cumbersome to place in
13. main section of the business plan
14. Income tax returns
15. List of pertinent inventories
16. Manufacturing or production layout plans not included in main body of the business plan.

Task 16 - Presentation

Now you have completed your business plan: what are you going to do with it?

Your most immediate purpose may be to present it to a banker or other source of finance or

assistance. You must remember that the main ingredient in any business is the entrepreneur, the man or woman who has initiated the business. Who stands to gain the most if it does well? Who stands to lose the most if it fails? And, on whose skill and energy does the business ultimately depend?

Do not make the mistake of thinking that your plan tells the whole story. Bankers and others are putting their money on you, not the plan. The plan only helps them to understand what you hope to do and shows them what help they can provide and what questions they should ask. You must use the plan to support your own presentation of yourself as an entrepreneur worth supporting.

The main use of your plan, however, is not for presentation to outsiders. If you have prepared it carefully and honestly, it represents a map to guide the future of your business. Like a road map, it cannot tell you what roadblocks you may meet, what breakdowns you may have, or even what unexpected shortcuts you may discover. Some people are so overwhelmed by the difficulty of preparing such a plan, and so relieved when they have finished it, that they think that there is nothing more to do. That is like someone who thinks that the way to go from A to B is buy a map of the route. If you are to achieve your plan, you will have to work extraordinarily hard, be willing to sacrifice your own comfort and pleasure, and almost certainly, to be able to succeed and to persuade bankers, customers, suppliers, employees, your family and even yourself that you will indeed succeed? You will have to be committed to the task you have set yourself. If you believe that it is worth doing, and that you can do it, then you probably will do it.

You can be certain, however, that it will not all go according to plan. How will you react when the unexpected happens? Some people blame fate, bad luck, their stars, or the gods, but others blame themselves, learn from their failure, and carry on better equipped to solve similar problems in the future. These are entrepreneurs, and now that you have finished your plan you are better equipped to join their ranks.

Activity

- ☐ *Please try to mention the most important types of supportive documents which are supposed be attached at the back of the business plan.*

- Dear learner, explain for what, whom, when, and how you present the business plan.
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Chapter summary

The business plan is the document which the entrepreneur prepares, based on the feasibility study, to attract investment.

Business planning is a three stage process. It involves understanding where you are; deciding where you want to go; and planning how to get there. Besides, it entails thorough SWOT (Internal Strengths and weaknesses and external opportunities and threats) analysis.

Business plan preparation follows a definite pattern of practical step-by-step tasks. These tasks range from introducing the business plan itself (Task 1) to presentation of the business plan to a banker or other source of finance or assistance. Notice here that the tasks of business plan are supplementary to one another.

If you want a bank, or anyone else, to put money into your business, or if you are thinking of putting money into it yourself, there are a number of questions that you must be able to answer. Most bankers and other investors demand a written business plan before they will invest any money, and many entrepreneurs like to have a written plan themselves, even if nobody else ever sees it.

The business plan pulls together all your analysis and decisions into one important document, i.e., marketing analysis, financial analysis, and organizational plan.

In a nutshell, the business plan is normally used to persuade investors to fund your idea.

Review questions

1. What necessitates the preparation of the business plan

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2. List and explain the ten entrepreneurial competencies (PECS) and indicate how they relate to the tasks of starting and running a business.

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3. Point out the main purpose of your market research.

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4. “The more you know about your potential customers the better off you will be.” Explain.

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5. What are the subjects of your focus while dealing with competition?

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6. What is meant by “key personnel”? And what should we include in the investigation of this part of the business plan?

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7. Describe the different approaches used in forecasting sales. Which approach will produce a realistic sales forecast?

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8. Distinguish between start-up costs and operating costs.

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9. What is the significance of cash flow analysis?

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10. What are the factors to be considered in selecting locations to business ventures?

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11. Explain the three stages involved in the planning process.

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CHAPTER FOUR

PRODUCT AND SERVICE CONCEPT

4.1 INTRODUCTION

In Entrepreneur's business, product/service development is the term used to describe the complete process of bringing a new product or service in the market and it's an ongoing practice in which the entire business is looking for opportunities as new products provide growth promise to businesses that allow them to strengthen their market position. The new product development process involves the idea generation, product design, and detail engineering; and also involves market research and marketing analysis. Intense global competition, short product and technology lifecycles, unpredictable consumer buying patterns and possible market stagnation makes new product development a critical activity in most businesses. Hence, this chapter explores the new product development process and at the same time sketch outs the product development procedure in reality where consideration of real life situation and consumer insight are the main concern. Besides, the chapter; considering (often entrepreneur), because of their lack of understanding of intellectual property, ignore important steps that they should have taken to protect these asset; will describe all the important types of intellectual property which have become unique problems to the Patent and Trademark Office.

Chapter Objectives

After completing this chapter, students will be able to:

- Describe the Concept of Product and Services;
- List Product/Service Development Process; and
- Discuss the Intellectual Property Protection.

4.2. The Concept of Product/Service

Many entrepreneurs find it difficult to identify a new product/service or a new market opportunity. To start and expand a small venture, an entrepreneur needs to identify opportunities for domestic and/or international expansion. As the new venture grows and matures a need for different management skills can occur as well as for a new infusion of the entrepreneurial spirit (corporate entrepreneurship). Entrepreneurs like Richard China or Mal Mixon, CEO of Invacare, understands this axiom and effectively manages change by continually adapting organizational culture, structure, procedures, strategic direction, and products in both a domestic and an international orientation.

Organization's success is dependent on customer satisfaction and delight. Customer satisfaction is achieved through the development of product and service, which have all attributes required by the customer. A success product or services do not only have an attractive package design but should be also able to provide robust performance. Thus, product design must be practical enough for production and powerful enough to provide a competitive advantage.

The essence of product design is to satisfy customer and maximizes the value for the customer at minimum cost. The merchandise or service should also be able to meet primary needs and desire of the customer. This may not require development of new merchandise, but an enhancement to existing merchandise or service.

Most companies apparently are introducing a wide variety of smaller, more efficient, and more intelligent products, coupled with a leaner, more efficient approach to operation. The goal is to create products and services by identifying an emerging trend and to match that trend with the right technology and understanding of the purchasing dynamics.

A successful startup depends on its distinctive and compelling proposition. This is how merchandise or services stand out from the competition and are compelling to the young company's customers.

The merchandise or service will succeed most if it either eliminates an existing pain or adds significant tangible benefits. It is easier to sell/deliver a new merchandise/service that eliminates a well-known existing pain, as opposed to sell an item or service that doesn't clearly solve a potential client's pain.

There also seems to be a popular myth that anyone can be successful by simply working on any given idea or opportunity. This isn't true! You can't. Most businessmen are very knowledgeable about the merchandise before they start, since even experienced operators will run into unexpected troubles when they start their new business. Novices generally introduce more problems than they can deal with, which only undercuts their ability to be lean, fast or effective.

4.3 Product/Service Development Process

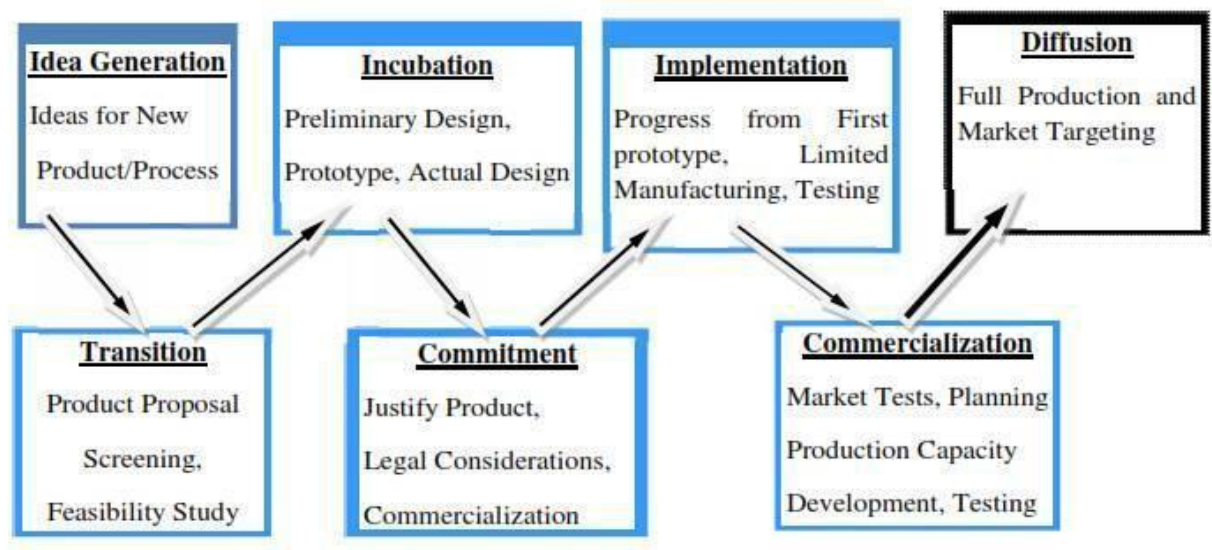
Once the opportunity is selected, and a business model has been designed, the next step is to develop a commercial version of the opportunity which in most cases is either a product or a service. One of the essential characteristics of a successful business is exemplified by its ability to continuously and rapidly develop new or improved versions of existing products that deliver values more than customers expect (*Palgrave, 2019.*)

Product development is the process through which companies react to market signals, respond to changes in customer demand, adopt new technologies, foray into new areas, and ensure continuous growth. It is a core process in achieving strategic objectives, renewal of the company business model

and deterring competition from displacing the company from its market position. Product/service development process is part of the overall new-venture creation process. Even though there are many models that advocate what the product/service generation process should look like, for this purpose we shall adopt four distinct stages.

These stages can be referred to as:

1. Idea Generation
2. Incubation
3. Implementation
4. Diffusion



The various stages of new product development process are explained next:

1. New Idea Generation

The new product development process starts with search for ideas. Companies have to encourage any new idea coming. The key to successful domestic and international entrepreneurship is to develop an idea that has a market for the new product/service idea conceived.

Some of the more fruitful sources of ideas for entrepreneurs include consumers, existing products and services, distribution channels, the federal government, and research and development.

2. Idea Screening

In the 2nd stage, the purpose is to lessen the number of ideas to few vital/valuable ideas. The ideas should be written down and reviewed each week by an idea committee who should sort the ideas into

three groups- **Promising Ideas, Marginal Ideas, and Rejects**: Each promising idea should be researched by committee member.

☐ **Concept Development and Testing**

Attractive ideas must be refined into fast able product concepts since people do not purchase ideas but they buy concepts. Any product idea can be turned into several product concepts. The questions asked probably include:-

- ☐ Who will use the product?
- ☐ What benefits should the product provide?
- ☐ When will people consume the produced?

Concept Testing: - calls for testing product concepts with an appropriate group of target consumers/customers, and then getting the consumers' reactions. At this stage, the concepts can be in words or picture description.

☐ **Marketing Strategy Development**

After testing the new product the concerned body must develop a preliminary marketing strategy plan for introducing the new product into the market. The marketing strategy will undergo further refinement in subsequent stages.

The marketing strategy plan consists of three parts: (1) Market size, structure, behavior ;(2) Planned price, distribution strategy, and marketing budget of the 1st year; and (3) Long run sales and profit goals, marketing mix strategy.

(b) Business Analysis

After management develops product concept and marketing strategy, it can evaluate the proposals' business attractiveness. Management needs to prepare sales, cost and profit projections to determine whether they satisfy the company's objective or not.

Estimated Total Sales: - Management needs to estimate whether sales will be high enough to yield satisfactory profit.

Estimating Cost and Profits: - After sales forecast the management should estimate the expected cost and profit at various levels of sales volume.

The company can use other financial measure to evaluate the merit of a new product proposal.

The simplest is **breakeven analysis**.

Activity

You are required to read on Breakeven Analysis and familiar with how it will be applied for the intended purpose.

(c) Product Development

If product concept passes the business test, it moves to R&D or engineering to be developed to one or more physical version of the product concept. Its goal is to find a proto type that the consumers/customers see as embodying the key attribute described in the product concept statement, Scientists must not only design the products" required functional characteristics but also know how to communicate its psychological aspects through physical cues and how will the consumer/customer react to different colors, sizes, weight & other physical cues.

When the prototypes are ready, they must be put through regroups functions and consumer/customer tests. Functional tests are conducted under laboratory & field conditions to make sure that the product performs safely and effectively (Durability, Speed, Cost, etc) Consumer testing can take variety of forms, from bringing consumers/customers into laboratory to giving them samples to use in their homes.

7. Market Testing

After management is satisfied with the products" functional and psychological performance, the product is ready to be dressed up with the brand name.

The goals are to test the new product is more authentic consumer/customer settings and to learn how large the market is and how consumers/customers and dealers react to handling, using and repurchasing the actual product.

Most companies know that market testing can yield valuable information about buyers, dealers, marketing program effectiveness, market potential & other matters.

Test Marketing yields several benefits include more reliable forecast of future sale, and pretesting of alternative of future sale.

8. Commercialization

When (Timing):- In commercializing, market entry timing is critical. If the company hears about a competitor nearing the end of its development work, it will face three choices. The 1st choice is

First Entry. Under this category, the firm usually enjoys the "first mover advantage" of locking up key distributors & gaining reputation. The 2nd choice goes with **Late Entry Strategy**- which has three advantages include:-

The competition will have borne the cost of educating the market;
The competing product may reveal fault that the late entrant can avoid; and The company can learn the size of the market.

The 3rd strategy- **Parallel Entry**- can be also chosen by the company to get in the market. The strategy to work, a prospective businessman can take the advantage of opting for the latest technology and production process and operate at higher volume of operation. This leads to reduced production cost and production of quality goods and services. A new businessman can thus provide improved quality goods and services at lower cost and further tap the market with an innovative marketing approach.

Where (Geographical Strategy):- The company must decide whether to launch the new product in a single locality, a region/several regions, in the national/international market.

To Whom (Target-Market-Prospect):- Within the rollout markets, the company must target its distribution and promotion to the best prospect group. Prime prospects for a new consumer/customer's product would ideally have the following characteristics:

- They would be early adapters;
- They would be heavy users;
- They would be Opinion leaders; and Could be reached at low cost.

How (Introductory Markets Strategy):- To sequence and coordinate many actives involved in launching a new product may/can use network-planning techniques such as **Critical Path Scheduling (CPS)**.

Activity:

Please read on Critical Path Scheduling technique and try to relate it with the how strategy.

4.4 Legal and Regulatory Frameworks for Entrepreneurs

Since there are many options that an entrepreneur can choose in setting up an organization, it will be necessary to understand all the advantages and disadvantages of each regarding such issues as liability, taxes, continuity, transferability of interest, costs of setting up, and attractiveness for raising capital. Legal advice for these agreements is necessary to ensure that the most appropriate decisions have been made.

One of the challenges the novice entrepreneur will face as she goes into business understands the regulatory environment which is made up of numerous laws and regulations. To operate as a legal businessperson and protect the business from unnecessary suits and liabilities, the entrepreneur needs to understand the various laws that govern his/her business. Following are the key legal issues for the entrepreneur.

4.5 Intellectual Property Protection/Product/Service Protection

4.5.1 What is Intellectual Property?

Intellectual Property which includes patents, trademarks, copyrights, and trade secrets represents important assets to the entrepreneur and should be understood even before engaging the services of an attorney. Too often entrepreneurs, because of their lack of understanding of intellectual property, ignore important steps that they should have taken to protect these assets.

Intellectual property is a legal definition of ideas, inventions, artistic works and other commercially viable products created out of one's own mental processes. In the same sense that real estate titles establish ownership of tangible items, intellectual property is protected by such legal means as patents, copyrights, and trademark registrations. In order to enjoy the benefits arising from the exclusive ownership of these properties, the entrepreneur needs to protect these assets by the relevant law. This is the reason why" experts strongly recommend that those in creative fields seek protection through official registration of their intellectual properties.

4.5.2 Patents

An entrepreneur who invents a new thing or improves an existing invention needs to get legal protection for her invention through a patent right. A patent is a contract between an inventor and the government in which the government, in exchange for disclosure of the invention, grants the inventor the exclusive right to enjoy the benefits resulting' from the possession of the patent.

 **Utility Patent:** A utility patent protects any new invention or functional improvements on existing inventions.



Design Patent: This patent protects the appearance of an object and covers new, original, ornamental, and unobvious designs for articles of manufacture. Like utility patents, design patents provide the inventor with exclusive right to make, use and/or sell an item having the ornamental appearance protected by the patent. This patent is appropriate when the basic product already exists in the marketplace and is not being improved in function but only in style. These patents are particularly important to companies such as shoe producers and product package design firms that need to protect their ornamental designs.

A patent provides the owner with exclusive rights to hold, transfer, and license the production and sale of a product/process. It is an intellectual property right and It is issued by government to the inventor. This exclusive property right can be granted for a number of years depending on the countries laws and type of property. Patents are property rights that can be sold and transferred, willed as well as licensed and at times used as collateral.

What Can Be Patented Then?

Processes: Methods of production, research, testing, analysis, technologies with new applications.

Machines: Products, instruments, physical objects.

Manufactures: Combinations of physical matter not naturally found. *Composition*

of matter: Chemical compounds, medicines, etc.

4.5.3. Trademarks

A trademark may be a word, symbol, design, or some combination of such, or it could be a slogan or even a particular sound that identifies the source or sponsorship of certain goods or services.

These are distinctive names, marks, symbols or motto identified with a company's product or service and registered by government offices. Unlike the patent, a trademark can last indefinitely, as long as the mark continues to perform its indicated function. Trademarks unlike patents are periodically renewed unless invalidated by cancellations, abandonment, or other technical registration/renewal issues.

Benefits of a Registered Trademark

- ☐ It provides notice to everyone that you have exclusive rights to the use of the mark throughout the territorial limits of the country.
- ☐ It entitles you to sue in federal court for trademark infringement, which can result in recovery of profits, damages, and costs.
- ☐ It establishes incontestable rights regarding the commercial use of the mark.
- ☐ It establishes the right to deposit registration with customs to prevent importation of goods with a similar mark.
- ☐ It entitles you to use the notice of registration (®).
- ☐ It provides a basis for filing trademark application in foreign countries.

4.5.4 Copyrights

Copyright is a right given to prevent others from printing, copying, or publishing any original works of authorship.

Copyrights provide exclusive rights to creative individuals for the protection of literary or artistic productions. It protects original works of authorship including literary, dramatic, musical, and artistic works, such as poetry, novels, movies, songs, computer software, and architecture. They pertain to intellectual property. Usually copyrights are valid for the life of the inventor plus a few decades.

4.6 The Intellectual Property System in Ethiopia

Ethiopia became a party to the convention establishing the world Intellectual Property Organization (WIPO) in February 1998 right after some time the Country had joined the Nairobi Treaty on the Protection of the Olympic Symbol in 1981. It is a member of the Treaty establishing the Common Market for Eastern and Southern Africa (COMESA) which was formed in 1994, the Partnership Agreement between members of the African, Caribbean and Pacific (ACP) Group of States and the European Union (EU).

The Ethiopian Government established the Ethiopian Intellectual Property Office in the year 2003 containing the understated Objectives:-

- ☐ To facilitate the provision of adequate legal protection for and exploitation of intellectual property in the country;
- ☐ To collect, organize and disseminate technological information contained in patent documents and encourage its utilization;

- To study, analyze and recommend policies and legislation on intellectual property to the government; and
- To promote knowledge and understanding of intellectual property among the general public;

The existing laws and directives in Ethiopia in the field of Intellectual Property (IP) are the Patent Proclamation and the Implementing Regulation, the Copyright and Related Rights Proclamation and The Trademark Registration Directive.

According to the proclamation in order to be granted a patent, an invention must fulfill three conditions- (1) it must be new- It should never have been published or publicly used before; (2) It should be capable of industrial application- It must be something which can be industrially manufactured or used; and (3) It must be "non-obvious"- It should not be an invention which would have occurred to any specialist working in the relevant field.

The proclamation excludes the following from patentability:-

Inventions contrary to public order or morality;

- Plant or animal varieties or essentially biological processes for the production of plants or animals; and
- Schemes, rules or methods for playing games or performing commercial and industrial activities and computer programs;
- Discoveries, scientific theories and mathematical methods; and
- Methods for treatment of the human or animal body by surgery or therapy as well as diagnostic methods practiced on the human or animal body.

Rights of a patentee include making, using and exploiting the patented invention in any other way. Any person who wants to use the patented invention has to get the authorization of the owner/inventor. The patentee does not have import monopoly right over the products of the patented invention in Ethiopia.

There are certain limitations of rights of the patentee included in the proclamation such acts done for non-commercial purposes; the use of the patented invention solely for the purposes of scientific research and experimentation; the use of patented articles on aircraft, land vehicles or vessels of other countries which temporarily or accidentally enter in to the air space, territory or waters of Ethiopia; acts in respect of patented articles which have been put on the market in Ethiopia by the owner of the patent or with

his/her consent; the use of the patented invention for national security, nutrition, health or for the development of vital sectors of the economy, subject to payment of an equitable remuneration to the patentee; the duration of a patent is 15 years which may be extended for a further period of five years if proof is furnished that the invention is properly worked in Ethiopia.

Trademark Directive is issued in the country in 1986 with the following objectives in that it helps:-

- To centrally deposit trademarks which are used by local and foreign enterprises to distinguish their goods or services;
- To distinguish the products or services of one enterprise from those of other enterprises and prevent consumers from being victims of unfair trade practices;
- To provide information on trademark ownership and right of use when disputes arise between parties;
- To provide required information on trademarks to government and individuals; and Protection is granted after publication of cautionary notice;

Copyright is protected on the basis of the copyright and related rights proclamation issued in 2004. The proclamation gives protection to literary, artistic and scientific works which include books, pamphlets, articles, computer programs and other writings; speeches, lectures, addresses, sermons, and other oral works; dramatic, dramatic-musical works, pantomimes, choreographic works, and other works created for stage production; musical works, with or without accompanying words; audiovisual works and sound recordings works of architecture; works of drawing, painting, sculpture, engraving, lithography, tapestry, and other works of fine arts; photographic and cinematographic works; illustrations, maps, plans, sketches, and three dimensional works related to geography, topography, architecture or science; derivative works; and collection of works, collection of mere data (databases) whether readable by machine or other form.

The Proclamation gives protection to:

- Works of authors who are nationals of or have their habitual residence in Ethiopia;
- Works first published in Ethiopia; or works first published in another country and published within thirty days in Ethiopia;
- Audio-visual works whose producer has his headquarter or habitual residence in Ethiopia; and

- Works of architecture erected in Ethiopia and other artistic works incorporated in a building or other structure located in Ethiopia.

The author of a work shall be entitled to protection, for his work upon creation where it is an original work; and written down, recorded, fixed or otherwise reduced to any material form. Quality of the work and the purpose for which the work may have been created is not taken in to consideration.

The rights of performers, producers of phonograms and broadcasting organizations are also protected by law. Copyright is protected for the life of the author plus fifty years. Fifty years for the rights of performers and producers of sound Recordings and 20 years for the rights of broadcasting organizations.

Chapter Summary

Entrepreneurs must always remember that marketing, advertising, or promotional activities are completely worthless, regardless of how clever, expensive, or perfectly targeted they are, unless one simple thing is accomplished--ask for the sale. This is not to say that being a great salesperson, advertising copywriting whiz or a public relations specialist isn't a tremendous asset to your business. However, all of these skills will be for naught if you do not actively ask people to buy what you are selling.

Your business is all about your customers, or clients, period. Everything you do in business must be customer focused, including your policies, warranties, payment options, operating hours, presentations, advertising and promotional campaigns and website. In addition, you must know who your customers are inside out and upside down.

Laws and regulations exist to protect competition, consumers, people in the workplace, and intellectual property; to allow bankruptcy; and to establish contracts.

Too often entrepreneurs, because of their lack of understanding of intellectual property, ignore important steps that they should have taken to protect these assets. This informs will describe all the important types of intellectual property which have become unique problems to the Patent and Trademark Office.

Patents, copyrights, and trademarks are legal way to protect intellectual property. A patent grants an inventor the exclusive right to make, use, and sell

Since all business is regulated by law, the entrepreneur needs to be aware of any regulations that may affect his or her new venture and will need legal advice.

Review Questions

1. What advice would you give to a business colleague who is about to start a new high-tech firm that has developed a new accessory for computer tablets? Would you recommend that s/he seek a patent immediately?
2. Imagine that you have developed a unique formula for a soft drink that, upon entering a person's mouth, analyzes the drinker's DNA to determine his/her favorite flavor, and then the drink instantly realigns its chemical composition become that flavor. Describe as how you can best protect this trade secret? Will you patent it? Why or why not?
3. What factors should s/he consider in the process of debating whether a patent would be appropriate?
4. What rights does owning a patent protect? How do you get this protection?
5. What tests must an invention pass to receive a patent?
6. What is the difference between a copyright and a trademark? Between a trademark and a brand?

CHAPTER – FIVE

MARKETING IN SMALL BUSINESS

5.1. Introduction

Dear learners as you know from the course principles of marketing, Marketing consists of a multitude of activities that include decisions about the company's product or services, pricing policies, promotions and methods of distribution. The ultimate goal is to facilitate exchanges between an enterprise and its customers. The exchange relationship exists as one party becomes willing to "give something of value" to "receive something of value" from the other party. Marketing is a process of conceiving that exchange, and then accomplishing the tasks necessary to deliver the goods or services in a manner that satisfies customers and meets business objectives.

Chapter Objectives

At the end of this unit students will be able to:

- Explain the concept of Marketing research
- Explain the term Marketing intelligence
- Determine the competitive analysis
- Understand the concept of Marketing strategies and International markets

5.2. The marketing perspective

Marketing involves four general activities that are important to emphasize because they capture the essence of marketing. The four activities concern decisions about the firm's product, its price, methods of promotion, and how products are distributed.

Product: Product includes physical objects or services being sold, together with packaging, image, brand name and warranty. In addition, a product includes physical attributes that influence consumer's perceptions, such as colors, shapes, sizes and materials.

Price: Price is the monetary unit required for a purchase, and from an entrepreneur's view point, it is the unit of income. Prices communicate information about value, image and competition, and they influence decisions about distribution, market segmentation, product characteristics and related services.

Promotion: The act of communication that provides consumers with information about a company's

products, its services or the venture itself is promotion. It is through promotional activities that the venture attracts consumers. They include advertising, personal selling, direct marketing, public relations.

Distribution: It is concerned with how products or services are made available to customers. Distribution can mean the physical channels or transporting products from manufacturers to end users, warehousing, wholesaling and retailing. It can also relate to marketing systems such as catalogues, telemarketing, franchising, and computer-based network markets

Market segmentation is breaking down a market into groups of customers with similar characteristics. The key for most small firms is to concentrate their efforts and resources on one or more closely defined market segments. Research studies show a relationship between profitability and firms that do this and thereby gain a high share of that market segment.

The purpose of segmentation is to find a way of describing groups of customers so that the firm can better communicate with them. This allows the firm to tailor the marketing mix to the needs of that segment and communicate the offering in an appropriate way, through an appropriate medium. Thus a market segment is one distinct customer group on which a business will concentrate its efforts. A market segment, also called market niche, keenly focuses an entrepreneur's efforts on product characteristics, pricing, promotion and channels of distribution related to a specific customer group.

Activity

□ What are the marketing mix elements?

What is segmentation?

(You can use the space provided)

5.3. Marketing research Small and Micro Enterprises

Marketing research is defined as the “systematic and objective process of gathering, recording, and analyzing data for aid in making marketing decisions”. The essence of marketing research is to provide information used in decision making, and for the entrepreneur, there are fundamental differences between market information needed prior to start up and after a firm is established.

Prior to opening for business, the entrepreneur wants to know whether a market exists for a new product

or service, who is likely to be a primary customer, how to position the enterprise in the market, and how the product or service is priced, promoted and distributed. Addressing these issues becomes part of the pre-start-up planning process. Once a firm has become established, much of this information is authenticated through actual experience, and market research expands to include a continuous competitive analysis.

5.3.1. Market research in the pre-start-up phase

Before entrepreneurs actually commit themselves to opening a business they have to answer the following;

1. Who is the customer? A clear profile of potential customers is a basic element of market research. Customers may be young or old, married or single, teachers or students, homeowners or renters, poor or wealthy.

- ☐ Sex and age: These are two essential characteristics to identify in the customer scenario.
- ☐ Income status: The ability to buy and the amount of money will influence the product or service concept, price, nature of promotions, and method of distribution.
- ☐ Occupation and education: Both of these factors can significantly influence an entrepreneur's decisions.
- ☐ Other customer characteristics: These include family profiles, such as being married, single, or divorced; teenage children away at college, one of both parents working etc. Customers can also be identified by ethnic group, religion and domicile.

2. Where is the market?

Part of the customer scenario will involve locating the potential customer base-large metropolitan areas, suburban communities, small cities, and rural towns.

- ☐ Market size and changes. It is important to determine the potential for current and future sales.
- ☐ Local market characteristics: differ significantly because of population size, economic development, industrial profile, ethnic groups, weather, legislation and culture.
- ☐ Segmenting the market: A market segment is one distinct customer group on which a business

will concentrate its efforts. It keenly focuses an entrepreneur's efforts on product characteristics, pricing, promotions and channels of distribution related to a specific customer group.

Activity

3. Competition: Who are the market players?

Existing competitors should be identified and finding out the products or substitutes.

Distribution: How will customers be reached? A distribution system is the physical process of getting products to market or providing services.

Sources of market intelligence

- ☐ Existing competitors: identified through telephone directories, association, licensing agencies, advertisements, and public documents
- ☐ Trade publications: specialized publications, magazines, newsletters, catalogs, and brochures.
- ☐ Securities Analyst's Reports: Securities brokers, investment bankers, private investment companies, and experienced private investors.
- ☐ Government sources: volumes of government reports and documents in the public sector. (e.g. Department of Commerce, Chamber of Commerce etc)
- ☐ Potential customers: informal discussion with the end-users.

5.3.2. Competitive analysis: Research after start up

A competitive analysis is essentially a structured method of examining an organization or industry in order to provide a clear understanding of the factors that affect a business. Michael Porter's (Competitive Strategy) five forces model of competition, is a strategic management technique for established profit-seeking companies.

1. The Threat of entry

What is the threat of other companies entering the industry? Some points to be considered are;

- ☐ **Capital requirements:** If the type of business requires a large critical capital investment, fewer entrepreneurs are likely to enter the industry.
- ☐ **Economies of scale:** Large sales volume offers a product or service at a competitive price. Due to mass scale production, the cost of production can be minimized, which benefits the firm.
- ☐ **Experience:** Cost advantages are often enjoyed by those who were first into a business or who have experience in the technology required.
- ☐ **Distribution systems:** Lacking established distribution systems or access to them is a major barrier to new entrants.
- ☐ **Differentiation:** The extent to which an enterprise can establish a brand image, service, product innovation, or reputation describes its differentiation or distinct competency. By being distinct, an enterprise can command its market niche, discouraging new entrants. If entrepreneurs can establish unusual niches through differentiation, they may successfully barricade themselves against new competitors.

Entry barriers

- | | |
|---|---|
| ☐ Economies of scale | ☐ Brand identity |
| ☐ Proprietary product difference | ☐ Switching cost |
| ☐ Capital requirement | ☐ Government policy |
| ☐ Access to distribution | ☐ Expected relations |
| ☐ Obsolete cost advantage | |

2. The power of buyers

Entrepreneurs may think in terms of retail customers, but often they are in the position of selling to organizations much larger than their own enterprises. When buyers are relatively large and command a high percentage of the smaller company's sales, the buyers wield negotiating power; entrepreneurs

become price takers and often rely for their very existence in one or two buyers. Assuming few major obstacles to entry-competitors can mount significant challenges by outbidding the entrepreneur for price buyers. In addition, buyers may arbitrarily choose to create their own capability to supply the entrepreneur's products or services.

Determinants of buyer power

- ☐ ☐ Bargaining leverage
- ☐ ☐ Buyer information
- ☐ ☐ Buyer concentration vs. firm Concentration
- ☐ ☐ Ability to backward integration
- ☐ ☐ Substitute products
- ☐ ☐ Buyer volume
- ☐ ☐ Pull through
- ☐ ☐ Buyer switching cost relative to Firms
- ☐ ☐ Price sensitivity

3. The power of suppliers

When entrepreneurs are buyers, they must be concerned with the market power of their suppliers. Most new ventures start small and consequently buy materials and supplies from larger companies. Therefore, suppliers control prices and terms of sale. This situation usually results in high costs to the new enterprise, and if the entrepreneur is in a low-margin business (such as fast food retailing) the market leverage created by a powerful supplier can dictate success and failure. Supplier power is taken to be high when there are only a few suppliers giving an entrepreneur few options to shop for inventory.

Determinants of supplier power

- ☐ ☐ Differentiation of inputs
- ☐ ☐ Importance of volume of suppliers
- ☐ ☐ Switching cost of suppliers
- ☐ ☐ Cost relative to total purchase in the industry
- ☐ ☐ Presence of substitute inputs
- ☐ ☐ Impact of input on cost and differentiation
- ☐ ☐ Supplier concentration

4. The threat of substitutes

A direct substitute is one that performs the same services or has exchangeable attributes with respect to the entrepreneur's business. Indirect substitutes exist as choices between unlike products or services when buyers make allocation decisions. Entrepreneurs with special use products, such as medical equipment, have few direct or indirect substitutes to consider. Those in commodity goods, such as soft drinks, must consider many direct substitutes but few indirect ones because the consumer rarely makes a rational choice among dissimilar expenditures. Entrepreneurs in high priced durable goods such as VCR's or furniture, have tremendous competition from direct and indirect substitutes.]

5. Competitive rivalry

The extent to which an enterprise faces competitive rivalry is partially the result of a combined effort of the other four forces. Rivalry also depends on the nature of the industry, trends towards new technology, industry growth potential, and intensity of competition among major market players. If all competitors are roughly the same size, then the industry will be sensitive to prices and advertising, but relatively insensitive to outsiders. If an industry has companies of various sizes with differentiated products, then product attributes, prices, promotions, and distribution methods will result in market confusion and instability.

Rivalry determinants

☐ ☐ Industry growth	☐ ☐ Product Difference	☐ ☐ Information complexity
☐ ☐ Fixed/storage cost	☐ ☐ Brand identity	☐ ☐ Diversity of competitors
☐ ☐ Intermittent over capacity	☐ ☐ Switching costs	☐ ☐ Corporate stakes
	☐ ☐ Concentration and balance	☐ ☐ Exit barriers

5.4. Marketing Strategies Small and Micro Enterprises

A marketing strategy is a formulated plan that describes how a new venture will compete. It focuses the enterprise the activities related to competing in its market niche, subsequently providing guidelines for decisions about strategic objectives, allocation of resources, and responsibilities required to implement a

marketing plan.

Strategic objectives

Objectives vary; some are simple, others can be quite complex. Entrepreneurs should be able to establish objectives that can be easily measured. Several types of objectives can be considered with similar measurable criteria.

Growth

Growth is measured through sales activities and should be expressed in terms of sales or units sold. The sales volume should reflect accurate sales forecast.

Profitability

Every commercial enterprise will have profit objectives, but these can be expressed in several ways. In a business where prices and costs are sensitive, an entrepreneur will want to track “return on sales” to monitor the gap between income and expenses, and calculate a targeted “rate of return” on assets, equity and investments. Most companies can use these criteria to indicate how well they are utilizing assets to generate sales.

Customer service

An essential objective is to define how the enterprise will serve customers. The definition can be expressed in terms of product quality, diversification, or innovation.

Human resources

Most excellent companies have resource objectives such as helping employees improve their career opportunities, or improving performance through job skill training. Entrepreneurs can learn from larger firms that well-articulated objectives for human resources.

Other objectives

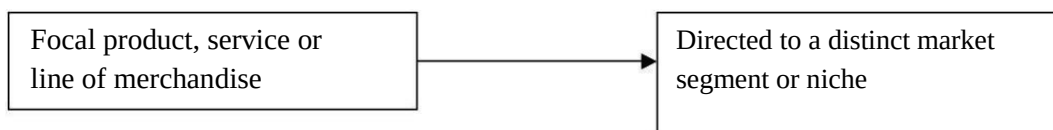
All entrepreneurs want something from their enterprises; their preferences may include autonomy, opportunity to be innovative, or the challenge of a new life style. Personal objectives will be accounted for a well-articulated marketing strategy that guides decisions.

General approaches to strategy

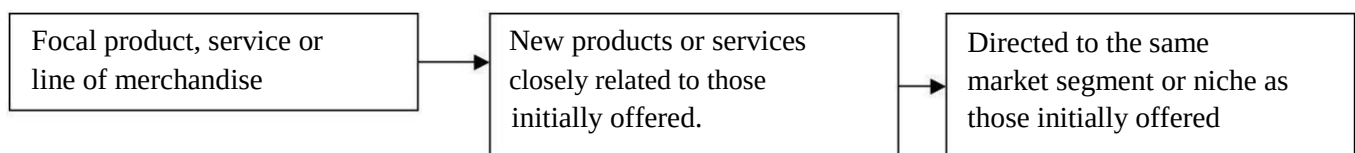
Most new ventures concentrate on a product or service in a select market, and although entrepreneurs may think about diversification. They must first establish the fundamental business endeavor. Once established, a venture may be positioned to diversify into new products or markets. These strategies are called *product or market diversification*. A *vertical integration* is a strategy of expanding backward into the vendor chain to secure resources, or of reaching forward into distribution channels to consolidate intermediaries. The primary strategies for new ventures are shown below;

Common start-up strategies

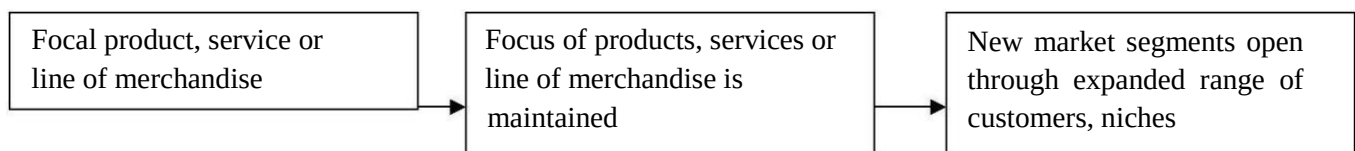
Concentration



Concentric diversification of products and services



Concentric diversification of markets or customers



Concentration

Entrepreneurs will want to consider how to grow, and the pace of growth. An intense growth can be achieved through “market penetration” tactics that include low prices, pervasive advertising, and sales promotions. Growth can also be achieved by concentrating on a specific market with high-priced goods for select clients in up market locations.

New market development

Another method of intense growth is to develop several closely associated markets. This is called concentric diversification in which the entrepreneur emphasizes finding new customer niches.

New Product Development

A third alternative is *product diversification* which means to develop new products or services that are closely associated with existing product and services. This is also called *concentric diversification*, and in some instances, *related diversification*. Entrepreneurs consciously choose to add to their product lines, yet they stick close to their initial products or services, building on their distinct competencies.

Other Strategy Considerations

Business plans that are successful in attracting investors and lenders will have a market strategy that portrays a vision of accelerated growth. A proposed new product might be acceptable to investors only if the entrepreneur intends to set up a wholesale distribution system or establish a plant for manufacturing. These options for “integration” imply an early plan to stage the enterprise—that is to time the sequence of events to make it successful.

Activity

□□ What is market strategy?

5.5 International marketing

International marketing is concerned with the marketing issues arising in the management of the firm's international operations" (marketing in international boundaries). The concept of marketing the management processes which identifies, anticipates, and supplies customer requirements efficiently and profitably.

It is the process by which individuals and companies:

- ☐ Identify needs and wants of customers in different international market
- ☐ Provide products, services and ideas competitively to satisfy needs and wants of different customer groups
- ☐ Communicate information about the product and service and
- ☐ Deliver the products and services internationally using one or combination of foreign entry models.

International markets differ

- ☐ Political, economic, social, technological, legal and environmental
- ☐ In customer behavior/ market segment
- ☐ In competition
- ☐ In market practices

International markets success factors

- ☐ A clear competitive focus
- ☐ An effective relationship strategy
- ☐ Well managed organization

Activity

☐ **What is international marketing?**

Chapter summary

Marketing consists of a multitude of activities that include decisions about the company's product or services, pricing policies, promotions and methods of distribution.

Market segmentation is breaking down a market into groups of customers with similar characteristics.

Marketing research is defined as the "systematic and objective process of gathering, recording, and analyzing data for aid in making marketing decisions". Market research can be conducted before starting a business or after establishment of the business.

A competitive analysis is essentially a structured method of examining an organization or industry in order to provide a clear understanding of the factors that affect a business. Michael Porter's (Competitive Strategy) five forces model of competition, is a strategic management technique for established profit-seeking companies. They are Threat of entry, power of buyers, power of suppliers, threat of substitutes and Competitive rivalry

Concentration, New market development, New Product Development and business plan are Marketing Strategies Small and Micro Enterprises

International marketing is concerned with the marketing issues arising in the management of the firm's international operations" (marketing in international boundaries). The concept of marketing the management processes which identifies, anticipates, and supplies customer requirements efficiently and profitably.

Review questions

Choose the best answer

1. In _____ strategy, an intense growth can be achieved through "market penetration" tactics like; low prices, advertisement and sales promotions.
 - A. Concentric diversification of market
 - B. Concentric diversification of products
 - C. Concentration
 - D. None of the above.

2. _____ is breaking down a market into groups of customers with similar characteristics.
- A. Market positioning
 - B. Market segmentation
 - C. Market strategy
 - D. None of the above
3. Which of the following is true about competitive analysis:
- A. It is strategy of researching after start-up of the venture
 - B. It determines the intrinsic long-run attractiveness of a market
 - C. It is a strategic management technique for established profit- seeking companies.
 - D. It is a structured method of examining an organization within its industry.
 - E. All
4. Among five forces model of competition which force encompasses all the rest forces?
- A. The threat of substitutes
 - B. The power of suppliers
 - C. The power of buyers
 - D. Competitive rivalry
 - E. The threat of entry
5. Cutting the price of products, usage of heavy advertisement and increasing sales promotions uses for which strategy?
- A. New market development
 - B. New Product Development
 - C. Concentration
 - D. Concentric diversification of markets or customers
 - E. Concentric diversification of products or services.
6. Which of the following „force“ is not part of the Five Forces model of industry competition?
- A. Potential for entry
 - B. Power of suppliers
 - C. Power of thought
 - D. Power of buyers
 - E. Power of substitutes
7. The document that does the best job of introducing prospective investors and other stakeholders with the business opportunity the firm is pursuing and how it plans to pursue it is the:
- A) Marketing Plan
 - B) Business plan
 - C) Feasibility analysis
 - D) Opportunity analysis
 - E) Industry analysis
-

CHAPTER – SIX

FINANCING SMALL BUSINESS

6.1. Introduction

Dear learners as an entrepreneur establish his own business; he/she has to consider certain issues such as legal forms of ownership, intellectual properties, risk and insurance management. Hence, this unit is designed in such a way that all these issues are to be discussed. First we will see the legal forms of business ownership then we will discuss about intellectual properties finally we will discuss about risk and insurance management processes.

Chapter Objectives:

By the end of this module, trainees will be able to:

- Learn about the cost of starting an enterprise.
- Know the different sources of finance to start a business venture.
- Learn the different financial analysis summary to control and manage the venture

6.2. Financial requirements

Finance is a key input of production. It is a pre requisite for accelerating the process of industrial development. Financial resources are essential for business, but particular requirements change as an enterprise grows. Obtaining those resources in the amount needed and at the time when they are needed can be difficult for entrepreneurial ventures because they are generally considered more risky than established enterprises.

6.3 Types and source of finance

Depending upon the nature of the activity, the entrepreneurs require three types of finances; i.e. short term, medium term and long term finances.

1. Short term finance

Short term finance refers to the funds required for a period of less than one year. Short term finance is usually required to meet variable, seasonal or temporary working capital

requirements. Borrowing from banks is a very important source of short term finance. Other important sources of short term finance are trade credit, installment credit, and customer advances.

2. Medium term finance

The period of one year to five years may be regarded as a medium term. Medium term finance is usually required for permanent working capital, small expansions, replacements, modifications etc. Medium term finance can be raised by;

- ☐ Issue of shares
- ☐ Issue of debentures
- ☐ Borrowing from banks and other financial institutions
- ☐ Ploughing back of profits by existing concerns.

3. Long term finance

Period exceeding 5 years are usually regarded as long term. Long term finance is required for procuring fixed assets, for the establishment of a new business, for substantial expansion of existing business, modernization etc.

The important sources of long term finance are;

- ☐ Issue of shares
- ☐ Issue of debentures
- ☐ Loans from financial institutions
- ☐ Ploughing back of profits by existing

concerns. **Sources of finances**

1. Equity financing

Equity is capital invested in a business by its owners, and it is „at risk“ on a permanent basis.

Because it is permanent, equity capital creates no obligation by an entrepreneur to repay investors, but raising equity requires sharing ownership.

2. Venture capital

Venture capital is an alternative form of equity financing for small businesses. Venture capitalists focus on high risk entrepreneurial businesses. They provide start-up (seed money) capital to new ventures, development funds to businesses in their early growth stages, and expansion funds to rapidly growing ventures that have the potential to “go public” or that need capital for acquisitions.

3. Personal sources

Entrepreneurs must look first to individual resources for startup capital. These include cash and personal assets that can be converted to cash. Family members and close friends become involved as informal investors.

4. Commercial banks

Most commercial loans are made to small businesses. Commercial banks provide unsecured and secured loans. An unsecured loan is a personal or signature loan that requires no collateral; the entrepreneur is granted the loan on the strength of his reputation. Secured loans are those with security pledged to the bank as assurance that the loan will be repaid.

5. Finance companies

There are three types of finance companies, and although all are asset-based lenders, each serves a different clientele. These are sales finance companies, consumer finance companies, and commercial finance companies.

Sales finance companies focus on loans for specific purchases like automobiles and farm machinery. Most of the customers are end users such as individuals who have their new cars financed through finance companies.

Consumer finance companies focus on short term loans secured by personal assets, and most consumer loans are for small amounts at high rates of interest. These loans are typically negotiated directly between finance companies and consumers for purchases such as

furniture, appliances, vacation trips and home repairs.

Commercial finance companies are focused predominantly on small business and agricultural lending. Their primary business is making loans on commercial, industrial and agricultural equipment.

6. Leasing

Leasing allows a small firm to obtain the use of equipment, machinery or vehicles without owning them. Ownership is retained by the leasing company, although in many cases there is a purchase option at the end of the lease period.

7. Hire purchase

Hire purchase provides the immediate use of the asset and also ownership of it, provided that payments according to the agreement are made.

8. Factoring

Factoring is a specialist form of finance to provide working capital to young, undercapitalized businesses. A small firm, which grants credit to its customers, can soon have considerable sums of money tied up in unpaid invoices. Factoring is a method of releasing these funds; the factoring company takes responsibility for collection of debts and pays a percentage (Usually 80%) of the value of invoices of the issuing company.

6.4. Control of financial resources

Financial problems

Fast growing small businesses have particular problems in controlling their finances. Growth brings frequent changes to the internal structures and external environment of a small firm. It is often difficult to ensure that financial control systems keep pace with the changing circumstances. The small business is likely to be confronted by a variety of financial problems as it advances through its life cycle.

Stage	Likely sources of finance	Financial issues
Conception	Personal investment	Under capitalization, because of inability to raise finance.
Introduction	Bank loans, overdrafts	Control of costs and lack of information.
Development	Hire purchase, leasing	„Over trading“, liquidity crisis.
Growth	Venture capital	„Equity gap“ appropriate information systems.
Maturity	All sources	Weakening return on investment
Decline	Sale of business/ liquidation	Finance withdrawn. Tax issues of business are sold.

The financial life cycle of a small firm

Cash flow-debtors and stock

Financial management in a small firm starts with the management of the cash flow. It is easy for cash resources of a small business to become „locked up“ in unproductive areas such as debtors, work in progress and finished stocks.

Debtors can hurt small business in two major ways;

1. They absorb cash and effectively increase the funding requirement of a small firm.
2. The longer a debt is alive, the greater the risk of a bad debt.

Stock represents a poor investment for a small firm's financial resources. Stock surpluses earn no money and the risk of deterioration if not used quickly. Stock management is about balances, and the optimization of resources. Stocks need controlling in three areas- raw material stock, work-in-progress, finished stock.

Costs and profits

Profits and losses are theoretical figures representing the difference between total earnings and total expenditures, incurred by a small firm in achieving those earnings. Profits or losses

should be translated into cash surpluses or deficits. Profitability can be improved by;

- ☐ Reduction of costs
- ☐ Increase of prices
- ☐ Increase of sales volume

Costs are classified as fixed or variable. Fixed costs remain unchanged in the short term. These costs will not vary with the volume of goods or services sold. They are the overheads of a business. Fixed costs do vary in the long term. Variable costs are operational expenses that change according to the volume of production.

6.5. Financial analysis

Small firms differ greatly in their approach to the provision of accounting information, and the use of forecasts and budgets for planning and controlling of business. The three most widely used financial summaries are;

- ☐ Profit and loss account or income statement
- ☐ Cash flow, and
- ☐ The balance sheet.

The profit and loss account, also commonly called as income statement shows how a business is doing in terms of sales and cost- and the difference between them of profit or losses.

The cash flow summary indicates the movement of cash into and out of the business. It differs in the important respect of reflecting credit given to customers and received from suppliers, as well as the amount of money invested in a business, or borrowed by it.

The balance sheet represents a summary of what money has been spent by a business, and what it has been spent on. It is usually an annual summary of the use and source of funds in a company.

6.6. Financial Management

In this subchapter emphasis is given to dealing with on how small and micro enterprises generate business transaction, record it and prepare different financial statements and budget.

1 Financial record keeping

Organizations are established to achieve certain objectives. While trying to achieve these objectives, they perform different activities, which are sources of different transactions. Once small and micro enterprises are established, they will have:-

- A) Different properties such as office chair, automobile
- B) Money or goods borrowed from others and
- C) Net capital of the business

To make clear different transactions of a business, let us see the following example.

Assume that SENFU DIGITAL PHOTO PLC has the following transaction as of January 1, 2010

- Purchased office equipment for 20,000; 10,000 for credit.
- Purchased automobile from MOENCO----for 250,000; 150,000 for credit.
- Purchase a building for ----- 150,000
- Kept cash birr 20,000

What is owned?

Cash ----- 20,000

Office equipment ----- 20,000

Automobile ----- 250,000

House 150,000

Total owned 440,000 birr

What is owed?

A.A Trading br 10,000

Dashen bank br 200,000

Moenco Br150,000

Total owed 360,000Birr

After identifying the total amount of what SENFU DIGITAL PHOTO owned (possess)

and owed (borrowed) it is possible to determine the total worth (equity) of the business as follows

- Total owned (possessed) ----- br 440,000 (A)
- Total owed (borrowed) ----- br 360,000 (B)
- Equity (A) – (B) ----- br 80,000

The property owned by the company in accounting term is known as equity. Equities can also be divided in to owners' equity and creditor's equity. The equity of the creditors are debts for the business organization and are called liabilities and the equities of the owners are called capital.

Expansion of the equation to give recognition to the two types of equities yields the following accounting equation.

$$\text{Asset} = \text{Liabilities} + \text{Capital}$$

An item to be called as asset it:-

- Should be the property of the organization
- Must be measured in terms of money
- The owner should exercise the right to possess, use, enjoy and dispose of the asset.

The business transaction of SENFU DIGITAL PHOTO PLC stated above can be rewritten in a more formal way called beginning balance sheet.

Balance Sheet

January 1, 2010

Asset		Liabilities	
Cash	20,000	Dashen Bank	200,000 br
Office equipment	20,000	Moenco	150,000 br
Automobile	250,000	A.A trading	10000

House	150,000	Total liabilities	360,000 br
		Capital	
Total asset	440,000	Senfu capital	80,000 br
		Total liabilities & capitals	440,000

Balance sheet is one of the accounting statements that list assets, liabilities and capital of a business entity at a specific date, usually at the close of the last day of the month.

Preparing financial statements

There are so many parties, which are interested about the financial situation of a small business organization. Financial statements such as income statement, balance sheet, and capital statements provide information about the financial condition of the organization. Financial statement can be prepared on monthly, quarterly and yearly basis as per the user's requirement for decision making.

1. Income statement

Income statement is a summary of the revenue and the expense of a business entity for the specific period of time such as a month or a year. Income statement has two major parts; the heading and the body. In the heading, the name of the business, name of the statement and the date of preparation are identified. In the body part, the revenue and the expense of the business organization are listed. There are four steps that we should follow to prepare income statement. These are:-

Step 1. Write the heading of the statement.

Write the name of the business and the statement and date of preparation.

Step 2. Prepare the revenue section.

Write the word revenue at the left side and write the income statement account sales in the

second line by moderately indenting.

Step 3. Prepare the expense section.

Like the revenue, the second part of the income statement i.e. expense is written at the left side below expenses account moderately indented from the left. The word total expense is written on the line beneath the last expense account title.

Step 4. Calculate the net income /net loss.

Net income or loss is calculated by subtracting total expense from the total revenue. The word net income is written at the left margin.

To make clear the preparation of net income, let us assume that SENFU DIGITAL PHOTO has recorded the following transactions during January 2010.

Registered a cash revenue of -----	50,000 birr
Paid salary -----	6,000 birr
Paid for utilities -----	3000 birr
Purchased supplies for cash -----	6,000 birr
Paid for advertising -----	8,000 birr
Purchase supplies for credits -----	5, 000 birr

Applying the aforementioned transaction, let us now prepare income statement of SENFU DIGITAL PHOTO as follows.

SENFU DIGITAL PHOTO PLC

Income statement

For the month ended January 31 2010

Revenue	
Sales	50000

Operating expenses

Advertising expense	8000
Salary expense	6000
Utilities expense	3000
Total operating expense	<u>17000</u>
Income before tax	33000
Tax 30%	<u>9900</u>
Net income	23100

2. Capital statements /statements of owners'' equity

It is one of the financial statements that shows the increase or decrease of the owner''s equity. The owner''s equity might be changed due to additional investment, income or loss and withdrawal by the owner.

Some information from income statement helps to prepare capital statement. Therefore, capital statements should be prepared next to income statements. Capital statement like income statement has heading and body. In the heading, the name of the statement, the name of the business organization and the date on which it is prepared is specified.

For the sake of clarity, let us prepare the capital statement of SENFU PLC, taking the initial capital of birr 20000 and the above prepared income statement.

SENFU DIGITAL PHOTO PLC

Capital statement

For the month ended January 31 2010

Capital January, 1 2010	80000
Add: Net income	<u>23100*</u>
Capital January 31, 2010	<u>103100</u>

* taken from the above income statement

The information on the capital statement helps to prepare the balance sheet. From the example, the capital of SENFU DIGITAL PHOTO PLC has increased. If the business was not profitable, its capital would have been decreased.

3. Balance sheet

Balance sheet is a list of assets, liabilities and capital of a business entity as of a specific date usually at the close of the last day of a month. A beginning balance sheet can be prepared during the establishment of the business organization. Thereafter, it can be prepared at different time when required, while preparing balance sheet it is customary to begin the asset section with cash which is followed by receivables, supplies, and other assets such as prepaid expenses that will be converted into cash or consumed in the near future. The assets of a relatively permanent nature such as equipment, buildings and land follow in that order

Steps To Prepare Balance Sheets

Step 1. Write the Heading

Like all other financial statements, write at the center the heading specifying the name of the business organization, the title of the statement and date it is prepared

Step 2. Prepare the asset section

Identify the nature of the assets as current assets those that will be expected to be changed into cash, or consumed usually within a year and fixed assets: that are of relatively fixed or permanent in nature. Write the heading current assets at the left hand side and below it list down current assets and below the last current asset write total assets. The same applies for

fixed assets. After writing all current and fixed assets write total assets indenting moderately.

Step 3. Prepare the liability section

Assess the nature of liability accounts and identify current and long –term liabilities. Current liabilities are liabilities that will be due within a short time (usually one year) and that are to be paid off out of current assets. Long – term liabilities are those, which will be due comparatively after a long time (usually more than one year). After identification of liabilities is finalized, write below total asset at the center of the line the word “Liability and Capital”, at the left hand side write current liability and below it list all current liabilities. Below the last liability account write the word total current liability. The same procedure holds true for long – term liabilities .

Step 4. Prepare the capital section

Capital is the word applied to the owner’s equity in the business. It is the residual claim against the assets of the business after the total liabilities are reduced. If the business is profitable, it increase the capital of the owner, if there is a loss, it will decrease the capital.

Following the aforementioned steps, let us prepare the Balance sheet of XY Trading P.L.C

SENFU DIGITAL PHOTO PLC
Balance Sheet
For the Month Ended January 31, 2010

Asset	
Current assets	
Cash	47000.00
Supplies	<u>11000.00</u>
Total current asset	<u>58000.00</u>
Plant Assets	

Automobile	250000.00
Building	150000.00
Office Equipment	20000.00
Total fixed assets	<u>420000.00</u>
Total assets	<u>478000.00</u>
Liabilities	
Current liabilities	
Account payable	5,000.00
Tax payable	9,900.00
Long term liabilities	
Dashen bank	200,000.00
Moenco	150,000.00
A.A trading	10,000.00
Total liabilities	<u>374900.00</u>
XY Trading capital	<u>103100.00*</u>
Total liabilities and capital	<u>478000.00</u>

* Taken from the above capital statement

Chapter summary

Finance is a key input of production. It is a pre requisite for accelerating the process of industrial development. Financial resources are essential for business, but particular requirements change as an enterprise grows.

Depending upon the nature of the activity, the entrepreneurs require three types of finances; i.e. short term, medium term and long term finances.

Equity financing, Venture capital, Personal sources, Finance companies, Commercial banks, Leasing, Hire purchase and Factoring are Sources of finances.

The small business is likely to be confronted by a variety of financial problems as it advances through its life cycle for conception to decline.

Due emphasis should be given to dealing with on how small and micro enterprises generate business transaction, record it and prepare different financial statements (balance sheet, income statement and budget)

Review Questions

Choose the best answer

1. The source of finance that does not have an obligation to repay but „at risk“ on a permanent basis is:
 - A. Venture Capital
 - B. Equity Financing
 - C. Personal Sources
 - D. Commercial Banks
 - E. Finance Companies
2. _____ is specialist form of finance which provides working capital to young, undercapitalized businesses.
 - A. Hire purchase
 - B. Leasing
 - C. Factoring
 - D. Venture capital
 - E. None.
3. One of the following sources of finance is created by an entrepreneur in the permanent basis with no obligation to repay for investment?
 - A. Venture capital
 - B. Equity finance
 - C. Finance companies
 - D. All
 - E. None
4. Which type of finance is required for the replacement and small expansion of the existing business?
 - A. Short-term finance
 - B. Long-term finance
 - C. Medium-term finance
 - D. A and B
 - E. A and C
5. One of the following is a source of finance in which it provides start-up (seed money) capital to new ventures during their early growth stages having potential to “go public”.
 - A. Equity financing
 - B. Venture capital
 - C. Personal sources
 - D. Commercial banks
 - E. Leasing

CHAPTER SEVEN

MANAGING GROWTH AND TRANSITION

7.1. Introduction

Dear students still now you seen concepts related to entrepreneurship and small business such as marketing and financing issues. Well, this is the last chapter in which you will see how you manage growth and transition of business. Basically the following are subtopics to be discussed in this particular chapter.

- ☐ Preparing for the launch of the venture
- ☐ Managing early growth of venture
- ☐ New venture expansion strategies and Issues (Mergers, Acquisitions, licensing and Franchising)

Chapter Objectives

After completing this chapter, students will be able to:

- ☐ Identify factors that affect business growth,
- ☐ Understand business expansion strategies,
- ☐ Know & internalize business ethics & social responsibilities.

7.2. Preparing For the New Venture Launch: Early Management Decisions

7.1.1 Record Keeping

It is necessary to have good records for effective control and for tax purposes. The entrepreneur should be comfortable and able to understand what is going on in the business. With software packages, much of the record keeping can be maintained on a personal computer. The goals of a good record keeping system are to identify key incoming and outgoing revenues that can be effectively controlled.

a. Sales (Incoming Revenue)

It is useful to have knowledge about sales by customer both in terms of units and dollars. The entrepreneur of a retail store might try to identify the profile of the type of customer that patronizes the store. Retailers also like to have information on specific customers. Credit card purchases can be tracked for information on the type and amount of merchandise purchased. An Internet venture can maintain purchase history data on the types of products purchased. Customers' e-mail addresses can be requested so the customer can be notified of sales. Some

Internet firms have established a free membership as a means of following up. In a service venture, records would need to be maintained on when a customer paid their monthly fee. As cash flow problems are the most significant cause of new venture failure, good payment records are necessary.

b. Expenses/Costs (Outgoing Revenue)

Records of expenses are easily maintained through the checking account. It is good business practice for the entrepreneur to use checks as payment for all expenses in order to maintain records for tax purposes. Canceled checks provide proof of payment. In the early stage, it may be desirable to make all payments on time to establish credibility with suppliers. The entrepreneur should maintain information about employee either in a software program or in a card file. It may be necessary to maintain records on all assets owned by the business.

c. Other Records

The entrepreneur should maintain information about employees either in a software program or in a card file. Records on all assets owned may be needed. With a good record keeping system it is easy to maintain controls over cash disbursements, inventory, and assets.

7.1.2 Recruiting and Hiring New Employees

The entrepreneur will generally need to establish procedures and criteria for hiring new employees.

Advertising in local newspapers and referrals from friends and associates is most effective for entry-level positions. For senior management the most effective strategy is networking with

friends and business associates. Personnel agencies may also be considered if there are no other effective options. Once resumes have been collected some basis of determining each candidate's strengths should be made.

Some criteria must be used in the resume evaluation. Factors such as education, prior experience, entrepreneurial activities, and interests can be used to assess candidates. From the initial screening of resumes, a few candidates can be invited in for an interview. Most firms use an interview form with critical factors listed for evaluating the interview candidates. The goal should be to hire not only the best candidate but also someone who will perform well in the entrepreneurial environment and provide a long-term solution to the available position. Acquiring senior talents can be critical to the venture's ability to successfully meet its growth goals.

Recruiting for upper management in an entrepreneurial firm

Many executives choose to become part of the entrepreneurial process rather than continue working in structured big business. The entrepreneur should use all his or her contacts and recognize that every potential candidate is different.

If the entrepreneur has no expertise in financial analysis, marketing research, or promotion, he or she should hire outside experts. There are accountants, financial experts, and advertising agencies that cater to new ventures.

7.1.3 Motivating and Leading the Team

The entrepreneur will usually be a role model for any other employees. It is important that the founder assume the role of leader to the management team and employees. Communication with managers and employees is one of the most important leadership qualities. Good work ethic will go a long way toward achieving financial and emotional success. During the early stages employees need incentives to remain committed and loyal to the long run success of the new venture.

Leadership is also influencing and inspiring others in the organization to strive to meet the mission of the venture. Below are some behaviors that can exhibit the leadership qualities

necessary for the new venture.

- ☐ Set an example with an ethical set of values for other managers and employees.
- ☐ Show respect and concern for the personal well being of employees.
- ☐ Don't try to do everything yourself.
- ☐ Recognize the diversity of employees and how they should be treated.
- ☐ Encourage and praise others in the organization when deserved.
- ☐ Provide incentives and awards for quality work effort and new ideas.
- ☐ Recognize the importance of employees having fun at their jobs.
- ☐ Be aware of the need for future strategic planning.

7.2.4. Financial Control

The entrepreneur will need some knowledge of how to provide appropriate controls to ensure that projections and goals are met. Cash flow statement, income statement, and balance sheet are key areas needing careful management and control. Some financial skills are necessary for the entrepreneur to manage the venture during the early years.

a. Managing Cash Flow

An up-to-date assessment of cash position, such as a monthly cash flow statement, is needed. The cash flow statement may show the actual amounts next to the budgeted amounts. It is useful for adjusting the proforma and indicating potential cash flow problems. A cash flow crisis can occur suddenly and unexpectedly. Cash flow analysis can also involve sensitivity analysis: for each monthly expected cash flow the entrepreneur can use a +/-5% that would provide a pessimistic and optimistic cash estimate. For the very new venture it may be necessary to prepare a daily cash sheet. Comparison of budgeted or expected cash flows with actual cash flows can provide an assessment of potential cash needs and indicate possible problems in the management of assets and control of costs.

b. Managing Assets

In addition to cash management, other items such as accounts receivable and inventory also need to be controlled. Management of credit may include acceptance of credit cards or use of internal credit. Using outside credit cards shifts the credit risk to the outside company but increases costs. Using internal credit makes the firm responsible for collecting delinquent payments, and payment delays can create negative cash flows. The entrepreneur will need to be sensitive to major changes in accounts receivable and should always compare actual with budgeted amounts. Inventory is an expensive asset, and requires careful balance. If inventory is low and the firm cannot meet demand, sales will be lost. Carrying excess inventory can be costly. An inventory control system allows the company to monitor key figures, such as inventory turnover and percentage of customer complaints. The entrepreneur will need to determine the value of inventory and determine how it affects the cost of goods sold. Most firms use a **FIFO** (first-in, first-out) system since it reflects truer inventory and cost values. There are good arguments for the use of **LIFO** (last-in, first-out) in times of inflation. The decision to convert from a FIFO to a LIFO system is complex and requires careful evaluation. It is necessary to decide if inventory is to be grouped into categories or to cost each item individually. All inventories must be costed by searching through historical records. An average inventory cost must be calculated. Conversion to LIFO can typically be beneficial if the following conditions exist: Rising labor, materials, and other production costs are anticipated. The business and inventory are growing. The business has some computer-assisted inventory control method capability. The business is profitable. The entrepreneur must keep careful records of inventory using perpetual inventory systems followed by a periodic physical count. Fixed assets have certain costs related to them, such as depreciation. If the entrepreneur cannot afford to buy equipment or fixed assets, leasing could be an alternative. Leasing may be a good alternative to buying depending on the terms of the lease and type of asset. Leases for automobiles may be more expensive than a purchase. However, lease payments represent an expense and can be used as a tax deduction. Leases are also valuable for equipment that becomes obsolete quickly. The entrepreneur should consider all costs associated with a lease-or-buy decision as well as the impact on cash flows.

c. Long-Term Vs. Short-Term Debt

The entrepreneur may need to borrow funds to finance assets and meet cash needs. Fixed assets are usually financed by long-term debt borrowed from a bank. Alternatives include borrowing from family members, having partners contribute more funds or selling corporate stock. Many of these options require the entrepreneur to give up some equity.

d. Managing Costs and Profits

An interim income statement helps to compare the actual with the budgeted amount for that period. The most effective use of the interim income statement is to establish cost standards and compare the actual with the budgeted amount for that time period. Costs are budgeted based on percentages of net sales. These percentages can be compared with actual percentages to see where tighter cost controls may be necessary. This lets the entrepreneur manage and control costs before it is too late. In later years, it is also helpful to look back on the first year of operation and make comparisons month-to-month. When expenses or costs are much higher than budgeted, the entrepreneur may need to determine the exact cause. Comparison of actual and budgeted expenses can be misleading for ventures with multiple products or services. For financial reporting purposes, the income statement summarizes expenses across all products and services. This does not indicate the marketing cost for each product nor should the most profitable product. Allocating expenses over product lines be done as effectively as possible to avoid arbitrary allocation of costs.

e. Taxes

The entrepreneur will be required to withhold federal and state taxes for employees and make deposits to the appropriate agency. Federal taxes, state taxes, social security, and Medicare are withheld from employees' salaries and are deposited later. The entrepreneur should be careful not to use these funds. The new venture may also be required to pay state and federal unemployment taxes. Federal and state governments will require the entrepreneur to file end-of-the-year returns of the business.

f. Ratio Analysis

Calculations of **financial ratios** can also be valuable as an analytical and control mechanism. These ratios serve as a measure of the financial strengths and weaknesses of the venture, but

should be used with caution. There are industry rules of thumb that the entrepreneur can use to interpret the financial data.

□□ *Liquidity Ratios*

Current ratio is commonly used to measure the short-term solvency of the venture or its ability to meet its short-term debts. The current liabilities must be covered from cash or its equivalent. The formula is: ***Current ratio = current assets/current liabilities***

While a ratio of 2:1 is generally considered favorable the entrepreneur should also compare this ratio with industry standards. *Acid test ratio* is a more rigorous test of the short-term liquidity of the venture. It eliminates inventory, which is the least liquid current asset.

The formula is: ***Acid test ratio = current assets – inventory/current liabilities***

Usually a 1:1 ratio would be considered favorable.

□□ *Activity Ratios*

Average collection period indicates the average number of days it takes to convert accounts receivable into cash. This ratio helps gauge the liquidity of accounts receivable or the ability of the venture to collect from its customers.

The formula:

Average collection period = accounts receivable/ average daily sales

This result needs to be compared to industry standards.

Inventory turnover measures the efficiency of the venture in managing and selling its inventory. A high turnover is a favorable sign indicating the venture is able to sell its inventory quickly.

The formula:

Inventory turnover = cost of goods sold/inventory

□□ *Leverage Ratios*

Debt ratio helps the entrepreneur assess the firm's ability to meet all its obligations. It is also a

measure of risk because debt also consists of a fixed commitment.

The calculation:

$$\text{Debt ratio} = \text{total liabilities} / \text{total assets}$$

Debt to equity ratio assesses the firm's capital structure. It provides a measure of risk by considering the funds invested by creditors and investors. The higher the percentage of debt, the greater the degree of risk to any of the creditors.

The calculation:

$$\text{Debt to equity ratio} = \text{total liabilities} / \text{stockholder's equity}$$

□□ Profitability Ratios

Net profit margin represents the venture's ability to translate sales into profits. You can also use gross profit as another measure of profitability. It is important to know what is reasonable in the particular industry as well as to measure these ratios over time.

The calculation:

$$\text{Net profit margin} = \text{net profit} / \text{net sales}$$

Return on investment measures the ability of the venture to manage its total investment in assets. By substituting stockholders' equity for assets, you can also calculate a return on equity.

The calculation:

$$\text{Return on investment} = \text{net profit} / \text{total assets}$$

The result of this calculation will also need to be compared to industry data. As the firm grows it will be important to use these ratios in conjunction with all other financial statements to provide an understanding of how the firm is performing.

7.3. Rapid Growth and Management Controls

Rapid growth may result in management problems. Before rapid growth occurs, the new venture is usually operating with a small staff and limited budget. Rapid growth may also dilute the leadership abilities of the entrepreneur. The entrepreneur's unwillingness to delegate

responsibility can lead to delays in decision making. The entrepreneur can avoid these problems through preparation and sensitivity. It may be necessary to limit the venture's growth if the future financial well being of the venture means a more controlled growth rate. The limits to the growth of any venture will depend on the availability of a market, capital, and management talent. Too rapid growth can stretch these limits and lead to serious financial problems.

Creating Awareness of the New Venture

In the early stages, the entrepreneur should focus on developing awareness of the products offered through: *Publicity, Internet Advertising, Trade Shows, Selecting an Advertising Agency*

In the early stages, the entrepreneur should focus on developing awareness of the products offered.

a. Publicity

It is free advertising provided by a media outlet. Many local media encourage entrepreneurs to participate in their programs. The entrepreneur can increase the opportunity for getting exposure by preparing a news release and sending it to as many media sources as possible. For radio or TV, the entrepreneur should identify programs that may encourage local entrepreneurs to participate. Free publicity can only introduce the company. Advertising can be focused on specific customers.

b. Internet Advertising-

The Internet is an excellent medium to create awareness and to effectively support early launch strategies. Creating a website is the most important first stage. The website should indicate: Background of the company. Its products, officers, address, telephone and fax numbers. Contact names for potential sales. Direct sales from the website may also be available. Significant advertising is needed to create interest and awareness of the existence of the website. It is important to change the content of the website as necessary. The entrepreneur may also consider using a banner ad, small rectangular ads similar to billboard ads that appear on browser websites.

c. Trade Shows-

Every industry has a trade or professional association that sponsors annual trade shows. Although creating a booth can be very expensive, trade shows are where hundreds of thousands of people observe or identify trends in their industry. There is strong evidence to indicate that the cost per sale from a trade show is significantly less than the cost per sale from a personal sales call.

d. Selecting Advertising Agency-

Advertising agencies can provide many promotional services. The advertising agency is an independent business organization composed of creative and business people who develop, prepare, and place advertising in media for its customers. The agency can provide assistance in marketing research. It is important to determine whether the agency can fulfill all of the needs of the new venture. A checklist of items that the entrepreneur may consider in evaluating an agency is useful. The agency should support the marketing program and assist the entrepreneur in getting the product effectively launched.

7.4. Managing Early Growth Venture

To grow or not to grow

To grow or not to grow should be an important part of the entrepreneur's strategic plan. For those who choose to grow their venture, it is necessary to be prepared for growth and to understand its implications. In many cases the growth may not be entirely voluntary. Customer may demand more goods, better services and even better prices.

Organizational Changes during growth

Many entrepreneurs find that as the venture reaches the growth stage they need to change the organizational culture.

Internal venture atmosphere based on employees attitudes. Some of the important guidelines to cultural change during growth involve the following:

- ***Communicate all matters to key employees.*** Trust and understanding by employees are important so that their roles and responsibilities during this stage of business are clear.

- ❑ ***Be a good listener.*** Learn what's on the mind of your employees and what they would do if they ran the company.
- ❑ ***Be willing to delegate responsibility.*** The entrepreneur cannot always be available to assess every management decision. Give key employees the flexibility to make decision without the fear of failure.
- ❑ ***Provide feedback consistently and regularly.***
- ❑ ***Provide continuous training to key employees.*** They in turn will be able to train others in the organization.
- ❑ ***Emphasize results to key managers with incentives built to encourage them to train and delegate within the roles.***
- ❑ ***Maintain a focus by establishing a mission with goals and using consensus in management decision making.***
- ❑ Establish a “*we*” ***spirit not a “me”*** spirit in meetings and memoranda to employees.

Entrepreneurial Skills and Strategies

It needs different skills and strategies to run the business activities.

■ ***Record keeping and financial control***

With growing venture it is sometime necessary to enlist the support and services of an accountant or consultant to support record keeping and financial control. These external services firms can also help train employees using the latest and more appropriate technology that can meet the needs of the venture.

■ ***Inventory control***

Efficient electronic data interchange (EDI) among producers, wholesalers, and retailers can enable these firms to communicate with one another. Linking the needs of a retailer to the wholesaler and producers allows for the fast order entry and response. These systems also allow the firm to track shipments internationally. Transportation mode selection can also be important in inventory management.

■ **Human resources**

Generally, the new venture does not have the luxury of a human resource department that can interview, hire and evaluate employees. Most of these decisions will be the responsibility of the entrepreneur and perhaps one or two key employees. Some entrepreneurs are managing this issue by hiring professional employer organization.

■ **Marketing skills**

As the company grows, it will need to develop new products and services to maintain its distinctiveness in a competitive market. This should be an ongoing process based on information regarding changing customers' needs and competitive strategies.

■ **Strategic planning skills**

Planning is continual process, particularly in a rapidly changing environment. It is unlikely that a plan that worked yesterday will be effective in today's marketplace. In **strategic planning**, three to five year plan that includes all functions of an organization outline should be prepared including:

- | | |
|--|---|
| ☐ ☐ Business mission | ☐ ☐ Strategy formulation |
| ☐ ☐ Situation analysis | ☐ ☐ Formulation of programs to meet goals |
| ☐ Internal environmental analysis | ☐ ☐ Implementation |
| ☐ External environmental analysis | ☐ ☐ Feedback and control |
| ☐ Goal formulation | |

■ **Time management**

Time is the entrepreneur's most precious yet limited resource. It is unique quantity: an entrepreneur cannot store it, rent it, hire it, or buy it. Entrepreneurs can always make better use of their time, and the more they strive to do so, the more it will enrich their venture as well as their personal lives. Process of improving individuals' productivity is possible through use of time in more efficient way.

■ Negotiation

Negotiation is the process by which parties attempt to resolve a conflict by agreement. There are two type of negotiation

- Distributive bargaining (competitive negotiation)
- Integrative bargaining (cooperative negotiation)
- **Integrative bargaining (cooperative negotiation)** - In this situation the entrepreneur is willing to let the other side achieve its desired outcome while maintaining a commitment to his or her own goals. ***Rational decision model is method of resolving conflict through objectives, analysis of alternatives and actions.***
- **Competitive negotiation (Distributive bargaining)** - does not allow the other party to achieve his or her goals. There is a fixed pie to be divided which means that the larger the opponent's share, the smaller the entrepreneur. In this competitive adversarial bargaining arena, each party tries to discover the others goals, values and perceptions. The methods use to collect information are indirect methods and direct methods.

Indirect methods- include discussing the person with anyone who has had previous contact, such as your own employees, the party employees, or outside individuals.

Direct methods-Whenever possible, he or she should meet informally with representatives of the other company, probing them to determine their levels of preparation. Frequently, insight can be obtained from response to relaxed, almost innocent questions.

7.5. New Venture Expansion Strategies and Issues

a. Joint Ventures

With the increase in business risks, hyper-competition, and failures, joint ventures have increased.

A **joint venture** is a separate entity involving two or more participants as partners. They involve a wide range of partners, including universities, businesses, and the public sector.

Types of Joint Ventures

The most common type is that between two or more private-sector companies. Some joint ventures are formed to do cooperative research. Another type of joint research for research development is the not-for profit research organization. Industry-university agreements for the purpose of doing research are also increasing. Two problems have kept this type venture from increasing even faster. A profit corporation wants to obtain tangible results-such as a patent-from its research investment and universities want to share in the returns. The corporation usually wants to retain all proprietary data while university researchers want to make the knowledge available. Joint ventures between universities and corporations take many forms, depending on the parties involved and the subject of the research. International joint ventures are increasing rapidly due to their relative advantages. Both companies can share in the earnings and growth. The joint venture can have a low cash requirement. Also, the joint venture provides ready access to new international markets.

Such a venture causes less drain on a company's managerial and financial resources than wholly owned subsidiary. There are drawbacks in establishing international joint ventures. The business objectives of the partners can be quite different. Cultural differences can create managerial difficulties. Government policies sometimes can have a negative impact on the venture. The benefits usually outweigh the drawbacks.

Factors in Joint Venture Success

One critical factor for success is the accurate assessment of the parties involved and how best to manage the new entity. A second factor involves the symmetry between the partners. Another factor is that the expectations about the results of the joint venture must be reasonable. The final factor is the timing. A joint venture should be considered as one of many options for supplementing the resources of the firm.

b. Acquisitions

An **acquisition** is the purchase of a company or a part of it in such a way that the acquired company is completely absorbed and no longer exists. Acquisitions can provide an excellent way to grow a business and enter new markets. A key issue is agreeing on a price. Often the structure of the deal can be more important to the parties than the actual price. A prime concern

is to ensure that the acquisition fits into the overall direction of the strategic plan.

Advantages of an Acquisition

- ☐ Established business
- ☐ The acquired firm has an established image and track record
- ☐ The entrepreneur would only need to continue the existing strategy to be successful
- ☐ Location is already established
- ☐ Established marketing structure
- ☐ An important factor that affects value of a firm is its existing marketing channel & sales structure
- ☐ With this structure already in place, the entrepreneur can concentrate on expanding to new target markets
- ☐ The total cost of acquiring a business could be lower than trying to buy a franchise
- ☐ Existing employees
- ☐ The employees of an existing business can be important assets
- ☐ They know the business and can help the business continue
- ☐ Employees already have established relationships with customers, suppliers, and channel members
- ☐ More opportunity to be creative
- ☐ More time can be spent assessing opportunities to expand or strengthen the business.

Disadvantages of an Acquisition

- ☐ ***Marginal success record-*** most ventures for sale have an erratic or even unprofitable record. It is important to review the records and meet important constituents to assess the future potential.
- ☐ ***Overconfidence in ability-***even though the entrepreneur brings new ideas, the venture may never be successful for reasons not possible to resolve.
- ☐ ***Key employee loss-***often when a business changes hands key employees also leave. In a service business, it is difficult to separate the actual service from the person who performs it. Incentives can sometimes be used to assure that key employees will remain with the business.

- **Overvalued**-if the entrepreneur has to pay too much for a business; the return on investment will not be acceptable. The entrepreneur will need to establish a reasonable payback to justify the investment.

c. Mergers

A **merger** is a transaction involving two or more companies in which only one company survives. Acquisitions are so similar to mergers, that the terms are often used interchangeably. A key concern in any merger or acquisition is the legality of the purchase. The Department of Justice frequently issues guidelines for horizontal, vertical, and conglomerate mergers. Merger motivations range from survival to protection to diversification to growth. A merger requires sound planning by the entrepreneur. Merger objectives must be spelled out with the resulting gains for the owners of both companies delineated.

The entrepreneur must evaluate the other company's management and resources to ensure that the weaknesses of one do not compound those of the other. The entrepreneur should establish a climate of mutual trust. The same methods for valuing the entrepreneur's company can be used to determine the value of a merger candidate. The process involves looking at the synergistic product/market position, the new market position, and undervalued financial strength. A common procedure is to estimate the present value of discounted cash flows and the expected after-tax earnings attributable to the merger.

d. Hostile takeover

One form of acquisition, hostile takeover has received increasing attention recently. Three items make hostile takeover possible.

- A low stock evaluation coupled with a strong performance
- A low debt/equity ratio, allowing the entrepreneur to use the assets of the company to fund the takeover.
- The percentage of institutional investors holding the company stock.

Since the objective of institutional investors is to make a profit they will frequently vote in favor of hostile takeover due to the anticipated gain in stock price and firm evaluation.

e. Leverage buyouts (LBO)

It occurs because an entrepreneur purchasing the venture believes that he/she could run the company more efficiently than the current owner. It occurs when an entrepreneur/employee/group used borrowed funds to purchase an existing venture for cash. The current owner is frequently an entrepreneur or owner who wants to retire. The owner may also be large corporation desiring to divest itself in a subsidiary that is too small or that does not fit its long term strategic plan.

f. Franchising

Franchising also represents an opportunity for entrepreneurs to expand the business. In the context of franchising, the entrepreneur will be trained and supported in marketing by the franchisor and will be using a name that has an established image. Franchising is also an alternative means by which an entrepreneur may expand his/her business by having others pay for the use of the names, process, products, service and so on.

Chapter summary

In Preparing For the New Venture Launch Record Keeping (Incoming Revenue, Outgoing Revenue and Other Records), Recruiting and Hiring New Employees, Motivating and Leading the Team and Financial Control (Managing Cash Flow, Managing Assets, Long-Term Vs. Short-Term Debt, Managing Costs and Profits, Ratio Analysis , Taxes) are considered as Early Management Decisions.

Rapid growth may result in management problems. In the early stages, the entrepreneur should focus on developing awareness of the products offered through: Publicity, Internet Advertising, Trade Shows, Selecting an Advertising Agency

Joint Ventures, Acquisitions, Mergers, Hostile takeover, Leverage buyouts (LBO) and Franchising are new venture expansion strategies.

Review Questions

Choose the best answer

1. Which one of the following is false about **leverage buyouts**?
 - A. It occurs when a low stock evaluation coupled with a strong performance
 - B. It occurs when the percentage of institutional investors holding the company stock.
 - C. It occurs when entrepreneurs use borrowed funds to purchase an existing venture for cash.
 - D. A&B
 - E. ALL
2. Which one of following leadership qualities is not necessary for the new venture?
 - A. Show respect and concern for the personal well-being of employees.
 - B. Don't try to do everything himself.
 - C. Recognize the diversity of employees and how they should be treated
 - D. All
 - E. None
3. Which one of the following statement is false?
 - A. Prices communicate information about value, image and competition
 - B. Price influence decisions about distribution, market segmentation, product characteristics
 - C. promotion is act of communication that provides consumers with information about a company's products, its services
 - D. Ventures attract consumers through Promotional activities.
 - E. None

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